The revised Swiss Collective Investment Schemes Regulations

Toward an alignment to European regulations

May 2013
Overview

Mid September 2012 the Swiss Parliament passed amendments to the Swiss Collective Investment Schemes Act (CISA). Following this, in February 2013, the Swiss Federal Council adopted the amendment to the Collective Investment Schemes Ordinance (CISO), which implements the revised CISA. Both enactments came into effect on 1 March 2013* with transitional provisions aiming to give enough time for the required adaptations to the market players.

The adopted amendments will mainly align the Swiss Collective Investment Schemes Act to European regulatory developments, namely to rules in the AIFM Directive** and the UCITS Directive.***

This document will focus on the following three selected areas of the revision of the CISA (revCISA) and CISO (revCISO) and elaborates them in more detail:

► Asset management
► Custody
► Distribution

* Except Art. 10, 24, 76 and 77 revCISA and Art. 34a revCISO.


Key areas of change by the revised Swiss Collective Investment Schemes Regulations

**Asset Managers of Collective Investment Schemes**
- Swiss based asset managers (AM) of foreign Collective Investment Schemes (CIS) need to hold a license with the Swiss Financial Market Authority (FINMA)
- Introduction of a *de minimis* exemption from the licensing requirement for AM managing Swiss and/or foreign CIS, as well as introduction of the opt-in-possibility for exempted AM
- Introduction of requirement of a cooperation and information exchange agreement between FINMA and the foreign home regulator in some specific cases
- Revised capital requirements introduced to be calculated as a percentage of the fixed costs and the AUM
- Scope of business activity of the AM specified to include at least portfolio and risk management

**Distribution of Collective Investment Schemes**
- Introduction of a new concept and definition of “distribution” of Swiss and foreign CIS in Switzerland replacing the previous concept of “public advertising”
- Reclassification of qualified investors as well as redefinition of HNWI and introduction of opt-out-rules for investors having signed a discretionary portfolio management agreement with a regulated financial intermediary and/or bank-independent portfolio manager fulfilling specific conditions
- Mandatory designation of a Swiss representative and paying agent independently of whether distribution activities related to a foreign CIS take place towards non-qualified (retail) or qualified investors and introduction of new requirements to adhere to for foreign CIS and its Swiss representatives as consequence thereof
- Introduction of new information and documentation duties related to the offering of CIS to investors (code of conduct)

**Custody**
- Introduction of the legal basis with regard to an appropriate organization of custodian banks
- New requirements for the appointment, review and monitoring of sub-custodians
- Enhanced liabilities for a custodian bank when appointing sub-custodians
The revision of the Law and the Ordinance on Collective Investment Schemes will bring about significant changes to strengthen investor protection as well as to safeguard the quality and competitiveness of the Swiss fund industry. And for Swiss based fund managers and their products, access to the European markets should be ensured as a result.

Key challenges for Swiss based fund managers and custodians

As rules for asset managers of CIS are being strengthened to meet international developments, it can be expected smaller firms which do not fall within the *de minimis* exemptions may not have sufficient means or sufficiently substantial structures in Switzerland to qualify for a FINMA license. Further regulation of managers of other assets (non-CIS) as well as, potentially, investment advisors, is currently in preparation in a new Swiss Financial Services Law (also referred to as Swiss MiFID).

All Swiss based licensees under the revised CISA will have to assess the impact of these new rules on their business and operating model, including their options and opportunities, and define their action points in order to comply with the new CISA rules in a timely manner. They would be well advised to also integrate in their assessment the regulatory changes pertaining to third country access rules arising out of the AIFM Directive and the upcoming revision of the MiFID Directive at European level. Unregulated asset managers, whether managing foreign funds or planning to manage Swiss funds, will need to understand and assess the requirements placed on them by the revised law.

From a custody perspective, the organizational requirements and duties of the depositary have been extended to align them to international requirements, notably the UCITS and AIFM Directives. These new requirements will likely necessitate most custodians to review the way they operate, as well as how they exercise supervision over sub-custodians.

Ernst & Young has extensive experience assisting asset managers and custodians analyzing regulatory requirements and their implications from a strategic and operational perspective. We can support you in analyzing the impacts that the revised CISA / CISO, as well as other European regulations, will bring about for your business, and align your business model accordingly. This includes supporting you in achieving regulatory compliance or with your application for a license.
## Key aspects in detail

### Asset management of Collective Investment Schemes

All Swiss based AM of CIS, both Swiss and foreign, have to hold a FINMA license.

**Revised requirements apply for the authorization of foreign AM.**

**Definition of AM’s business activity** includes both portfolio management and risk management.

An AM may also provide **additional services**, such as discretionary management of individual portfolios, investment advice services, distribution and representation of foreign CIS.

The requirements pertaining to **risk management**, **internal control system and compliance**, and their segregation with operational activities have been strengthened.

**Code of Conduct** requirements have been extended, notably in relation to conflicts of interest and duty of disclosure related to distribution activities.

**AMs need to be a:**
- company limited by shares
- partnership limited by shares, limited liability company, general or limited partnership
- Swiss branch of a foreign AM (subject to appropriate supervision in its home country (incl. branch) as well as requirements regarding sufficient funding and organization; a cooperation and information exchange agreement between the foreign home regulator and FINMA in place)

**Natural persons** are **not eligible** for an asset management license anymore.

**Revised capital requirements** have been introduced, which vary depending on the activities carried out. Capital must correspond to 25% of fixed costs and 0.02% of AUM exceeding CHF 250 Mio. An AM must hold additional capital to cover the risk of professional indemnity, or benefit from adequate insurance cover.

**De minimis exemption**: no license is required for an AM of CIS whose investors are qualified and which meets one of the following requirements
- with total AUM of max. CHF 100 Mio. (incl. assets acquired through the use of leverage) or
- with total AUM of max. CHF 500 Mio. (provided the managed portfolios are not leveraged and investors do not have redemption rights exercisable for a period of five years following the date of the initial investment) or
- if all investors are exclusively group companies of the corporate group to which the AM belongs

These AMs may **opt-in** for a FINMA license provided the foreign regulator in the home state of the foreign CIS or in the foreign distribution country of the CIS requires such a license.

Should the above threshold be exceeded at any time the AM will be required to notify FINMA within ten days and submit an application for authorisation within 90 days.

In case of a **single investor fund**, the fund management company or the SICAV may delegate the investment decisions to the single investor who may be exempted by FINMA from the AM licensing duty.

FINMA may – in justifiable instances – fully or partially exempt AMs from provisions of the CISA upon request in certain justified cases provided that:
- the ultimate purpose of the law is not compromised and
- the asset management has been delegated to the AM by one of the following entities: fund management company, SICAV, LP, SICAF, AM of the CIS, foreign companies subject to equivalent supervision

The **possibility to delegate** the task of asset management and the liability attached to such delegation remains in essence the same as under the former CISA. However, delegation abroad is only possible if a cooperation and information exchange agreement between FINMA and the home country authority of the AM to which an activity has been delegated is in place.

### Introduction of more stringent requirements for Swiss based asset managers

Have you assessed the impact of the revised legal requirements in terms of:
- Your own organization, including capital and competence / staffing requirements, externalization of services to third parties and the geographies in which you operate?
- Your products, especially foreign funds and their potential relocation to EU legislations?
- The possibility for you as fund management company to leverage your platform offering to service third party managers?
- Addressing changes within a wider EU context to integrate new third country access rules for those managers operating in the EU out of Switzerland?
Key aspects in detail

Without yet taking into consideration the FINMA-circular draft currently in consultation nor the specific aspects related to qualified investors entering into force on June 1, 2013.

Distribution of Collective Investment Schemes in and from Switzerland

**Distribution** of CIS is to be considered as “any offering and any canvassing” of:
- Swiss CIS in and from Switzerland
- foreign CIS in Switzerland
- foreign CIS from Switzerland, unless designed for qualified investors only under Swiss or applicable foreign law

**Qualified investors** are deemed to be:
- duly supervised financial intermediaries
- public corporations, pension funds and enterprises with a professional treasury department
- high net worth individuals (HNWI) who have opted in
- discretionary portfolio management customers of:
  - duly supervised financial intermediaries; or
  - bank-independent asset managers subject to AML, Code of Conduct rules of an industry body recognized by FINMA and whose portfolio management agreement complies with standards issued by FINMA-recognized industry bodies

unless they have opted out.

The following activities are not deemed distribution (“exceptions”):
- any offering/canvassing of CIS to duly supervised financial intermediaries
- provision of information on and subscriptions in CIS upon unsolicited request and execution-only transactions
- provision of information and subscription in CIS in the context of a written discretionary portfolio management agreement fulfilling the criteria outlined in the left column
- offering participation plans in form of CIS units to employees
- publication of prices, rates, NAV, tax data by duly supervised financial intermediaries

**Distribution of CIS to the following addressees qualifies as distribution to qualified investors**, subject to a light regime:
- public corporations, pension funds and enterprises with a professional treasury department
- high net worth individuals (HNWI) who have opted-in

If the CIS is:
- a Swiss CIS, the distributing party does not require a license; however the CIS needs to be approved by FINMA
- a foreign CIS, the distributor requires a license for distribution either by FINMA or a foreign home regulator. Moreover, a Swiss representative and paying agent for the foreign CIS must be appointed.

The foreign CIS does not need an approval from FINMA, however, its name must not be misleading or deceptive.

**Distribution** is - inter alia - subject to the following conditions:
- establishment and hand over to the client a record reflecting the client’s needs and the given recommendations (duty to keep written record)
- compliance with the code of conduct and informing the client about remuneration arrangements (duty of enhanced information)

The newly defined term of distribution will replace the former definition of public advertising

- How is your client base structured? Which actions need to be taken in order to continue to serve the current client base?
- Are all the necessary licenses in place? Will you need to appoint a representative and paying agent for your foreign CIS you offer in Switzerland?
- Are you operating your cross-border institutional business in a compliant manner? Have you all the necessary country manuals in place?
- Have you fully understood the implications of the revised CISA for your business model?
Key aspects in detail

Custody of Collective Investment Schemes

A custodian bank needs to have an appropriate organization as custodian bank for CIS in place. A minimum of three dedicated employees with signature rights is required.

Only custodian banks of Swiss CIS will need to hold a custodian bank license in addition to their bank license.

The duties of custodian banks have been enhanced to include, inter alia:

- the monitoring of the proper settlement and timely cash transfer of transactions executed
- the segregated record keeping of assets under custody
- the control of ownership and record keeping for non-transferable assets

The appointment of sub-custodians remains permissible (with the obligation of the CIS to disclose the risks attached thereto in the prospectus) provided:

- the appointment is in the interest of a proper safekeeping and
- the safekeeping of financial instruments occurs only with supervised sub-custodians (with a few exceptions)

Custodians appointing sub-custodians or central depositories have to examine and monitor:

- the adequacy of the internal organization, financial guarantees and knowledge
- the performance of regular external audits of the safekeeping function
- the performance of regular stock reconciliations
- the prevention of conflicts of interest

Liability regulations for sub-custodians have become stricter. A custodian bank remains responsible for any damages caused by its sub-custodian unless it can prove that it applied due care required by the circumstances while selecting, instructing and monitoring the sub-custodian. For the custodian bank, this means:

- shift in burden of proof
- enhanced monitoring duties

The revised CISA introduces the legal basis for the obligation of the SICAV to appoint a custodian bank.

FINMA may allow exceptions from this duty for SICAV for qualified investors having appointed a prime broker. However, from a practical point of view, this will have little impact as only a few SICAVs have been established under Swiss law so far.

Introduction of a stricter liability regime for custodian banks of CIS

- What will be the main impacts of the new regulation on the contractual agreements with the sub-custodians?
- Can the required segregation of assets be performed on a single fund level or can the products be grouped?
- Have you considered the more detailed organizational requirements that need to be met within one year?
- What are the main criteria for the monitoring of sub-custodians? How does this need to be documented?
- How can a custodian bank best protect itself with regard to the stricter liability regime?
Timeline

Much work will be required to adapt to the revCISA and asset management firms are best advised to assess revCISA’s implications on their organization as early as possible.

The revCISA sets clear timelines to comply with the new rules and requirements.

The steps and deadlines required to comply with the revCISA are outlined herein.

Some provisions will become effective at a later date:

- Art. 10, 76 and 77 revCISA on 1 June 2013 and
- Art. 24 revCISA and Art. 34a revCISO on 1 January 2014

Immediately after the revCISA entered into force:

- where investment decisions for Swiss CIS have been delegated to a foreign AM in a country without a cooperation and information exchange agreement in place - as required by the foreign law - the delegation has to be reported to FINMA
- where no transition period is stated, the respective changes enter into force immediately, e.g. stricter liability for custodian banks or the approval conditions for new foreign CIS

Within 6 months after the revCISA entered into force:

- any delegation of investment decisions to an AM who is not subject to supervision of a recognized supervisory body has to be reported to FINMA
- any AM of a foreign CIS, any distributor or representative of a foreign CIS - now subject to the revCISA - has to contact FINMA

Immediately after Art. 10, 76 and 77 revCISA entered into force:

- qualified investors having concluded a written discretionary management agreement with a duly supervised financial intermediary or a bank-independent asset manager may no longer become limited partners of a LP
- new requirements with regard to prospects, simplified prospectus and KID will be effective

Immediately after Art. 24 revCISA entered into force:

- parties involved in distribution of CIS are subject to the new duty to keep a written record
Within one year after the revCISA entered into force:

► where a required cooperation agreement with a foreign supervisory authority is not in place, the management company, SICAV or representative has to submit to FINMA a statement of that respective authority to enter into such an agreement
► foreign CIS approved for distribution to non-qualified investors must comply with the newly implemented requirements
► custodian banks have to comply with the organization requirements of the revCISO
► banks, securities dealer, insurance companies and asset manager being active as a representative of foreign collective investment schemes shall file an application for FINMA approval
► asset managers, established under Swiss law, existing fund management companies and SICAFs have to comply with the respective capital requirements
► licensees have to comply with the statutory provisions in terms of organizational structure, risk management, internal control system and compliance

Within 2 years after the revCISA entered into force:

► fund contracts, investment regulations and company agreements have to be adapted and filed for FINMA approval
► any delegation of investment decisions must satisfy the new requirements set out in the revCISA
► AMs of foreign CIS have to comply with the revCISA and file an application for FINMA approval
► custodian banks have to confirm that only eligible sub-custodians are appointed and delegation is in the interest of a proper safekeeping in compliance with revCISA
► representatives and distributors have to comply with the revCISA and file an application for FINMA approval
► foreign CIS distributed exclusively to qualified investors shall comply with the new CISA requirements
► financial intermediaries, distributing foreign CIS to qualified investors have to comply with the requirements of the revCISO
► LPs, having HNWIs as limited partners shall amend its company agreements

Within 2 years after the revCISA entered into force:

► HNWIs not meeting the new requirements are no longer permitted to invest in CIS designed for qualified investors

Within 5 years after the revCISA entered into force:

► existing encumbrances exceeding the threshold value shall be amended

Until 31 December 2016:

► unit certificates structured as bearer shares shall be converted into registered shares
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