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Revision of the Collective Investment Schemes Act – Amendments to Distribution

In the 2012 fall session, the Swiss parliament passed amendments to the Collective Investment Schemes Act (CISA). If a referendum is not launched, which it can be assumed will be the case, the revised act will enter into force at the beginning of 2013. By then, the ordinances to the revised CISA (revCISA) will also be available.

The reason for the revision was in particular the so-called Alternative Investment Fund Managers Directive (AIFMD) issued by the European Union (EU), which also applies to the European Economic Area (EEA), which namely includes Liechtenstein. Without an alignment of the Swiss act to the AIFMD, the distribution of units in funds, which are managed from Switzerland, would be massively more difficult if not entirely impossible within the EU and EEA. Furthermore, legislators would like to strengthen the competitiveness of the Swiss financial centre and expand investor protection with this revision.

The amendments overwhelmingly concern the portfolio management of collective investment schemes, their distribution and their custody. We are discussing these amendments in three publications. This publication deals with the amendments in the area of portfolio management.

1. Who falls under the revCISA?
Fundamentally, distribution is considered to be «every offering of and every promotion for collective investment schemes» and specifically (art. 3 para. 1 in conjunction with art. 2 para. 1 revCISA)
- of Swiss collective investment schemes;
- of foreign collective investment schemes in Switzerland;
- of foreign collective investment schemes from Switzerland unless these are not reserved for qualified investors under Swiss law or corresponding foreign law.

As regards the distribution of foreign collective investment schemes from Switzerland, this has to mean: Whoever distributes collective investment schemes from Switzerland to Spain, for instance, does not fall under revCISA when the collective investment schemes are reserved for qualified investors under Swiss or Spanish law.

It is unclear whether this applies analogously when the activity in Switzerland is limited to the conclusion of distribution agreements with foreign distributors without carrying out any actual distribution activity. Including this activity would not make any sense, because it is not the responsibility of Swiss law to protect foreign investors from foreign distributors. Furthermore, Swiss law cannot even protect foreign investors, since they don't have a contractual relationship with the Swiss unit and don't fall within the territorial scope of application of the revCISA.

2. What is not considered distribution?
The following activities don't qualify as distribution within the meaning of the revCISA (art. 3 para. 1 and 2 revCISA):
- An offer of and promotion for collective investment schemes which is exclusively directed at banks, securities dealers, fund management companies, asset managers of collective investment schemes, central banks and supervised insurance companies.
- The provision of information and the subscription of collective investment schemes which come about at the instigation or the self-initiative of investors, for example in the course of advisory agreements or the mere execution of transactions. This approach is also considered as passive distribution.
- The provision of information and the subscription of collective investment schemes based on a written asset management agreement with banks, securities dealers, fund management companies, asset managers of collective investment schemes and central banks.
- The provision of information and the subscription of collective investment schemes based on a written asset management agreement with independent asset managers, who (i) are subject to money laundering laws, (ii) are subject to the FINMA approved conduct rules of a regulatory organisation, and (iii) whose asset management agreement corresponds to the FINMA-conform guidelines.
- The publication of prices, rates, net asset values and tax data through supervised financial intermediaries.
- The offering of employee participation plans in the form of collective investment schemes.

The terms and conditions for distribution according to the revCISA do not find application for these activities. As regards all other distribution activities, a differentiation is made between distribution to qualified investors and public distribution:

3. Distribution to qualified investors
Qualified investors are deemed to be (art. 10 para. 3 – 3ter revCISA):
- banks, securities dealers, fund management companies, asset managers of collective investment schemes and central banks;
- supervised insurance companies;
- public corporations, pension funds and enterprises with a professional treasury department;
- high net worth individuals who declare to be qualified investors, although the Federal Council may attach conditions;
- investors, who have entered into a written asset management agreement with banks, securities dealers, fund management companies, asset managers of collective investment schemes or with qualified asset managers in accordance with art. 3 para. 2 let. c revCISA (see section 2 above), are deemed to be qualified investors provided that they have not declared not to be considered as qualified investors. This is in contradiction to art. 3 para. 2 let. c revCISA pursuant to which rule the subscription of collective investment schemes by such asset manager clients is not even considered as distribution (see section 2 above).
- Further persons designated by FINMA (art. 10 para. 4 revCISA).

If collective investment schemes are distributed exclusively to qualified investors, the following must be complied with:
- Distribution may only be carried out by supervised financial intermediaries, i.e. at

least distributors (art. 19 para. 1bis revCISA).
- A mandatory record must be made (see section 6 below).
- A representative as stipulated in art. 13 para. 2 let. h revCISA and a paying agent in Switzerland must be engaged for the collective investment scheme. These may only end their mandate with the consent of FINMA (art. 120 para. 4 and 2bis revCISA).
- The designation of the collective investment scheme may not give reason for deception and confusion (art 120 para. 4 and para. 2 let. b revCISA).

The following requirements, which were proposed by the Federal Council or parts of the Parliament, did not become law however:
- The approval of the documents of foreign collective investment schemes and the collective investment scheme itself through FINMA (art. 15 para. 1 let. e CISA *e contrario*).
- The requirement that foreign collective investment schemes must be subject to supervision equivalent to that under Swiss law and that that must fully conform to the applicable Swiss law.

4. Public distribution:
Any distribution qualifies as public which does not fall under the exception regulations of art. 3 para. 1 and 2 revCISA (see section 2 above) and which is not considered as distribution to qualified investors (see section 3 above).

The requirements for public distribution remain essentially unchanged when compared to the current legal situation (art. 13 and 120 para. 2 revCISA). This means:
- a distributor licence is necessary (art. 19 para. 1 CISA);
- the foreign collective investment schemes must be approved by the FINMA (art. 120 para. 1 revCISA);
- a representative and a paying agent in Switzerland must be engaged for foreign collective investment schemes. These may only end their mandate with the consent of FINMA (art. 120 para. 2 let. d and 2bis revCISA);
- the collective investment scheme, the fund management company / fund company, the asset manager and the custodian are subject to public supervision serving the purpose of investor protection (art. 120 para. 2 let. a revCISA);
- the fund management company / fund company and the custodian are subject to regulations, which are equivalent to the terms and conditions of the revCISA with regard to organisation, investors' rights and investment policy (art. 120 para. 2 let. b revCISA);
- the designation of the collective investment scheme may not give reason for deception and confusion (art. 120 para. 2 let. c revCISA);
- the existence of an agreement on the cooperation and exchange of information between the FINMA and the foreign supervisory authorities for the distribution.

The practical consequence of this is that – as in the past – only UCITS could be registered for public distribution in Switzerland and that there may even exist exceptions for these.

5. Fiduciary duties in distribution
An important change in the distribution will result from art. 20 para. 1 let. c revCISA. Under this, all licensees, including distributors and representatives, must inform appropriately the investors about the collective investment schemes (managed, in custody, and) distributed by them. This includes an obligation to completely, honestly and understandably orient investors about sales compensation in the form of commissions, fees and other monetary advantages.

It is questionable whether the investor can get this information not only from the distributor from whom he acquired the fund's units but also from the representative with whom, however, he does not have a contractual relationship. This would certainly be the case for representatives who are informed about the cash flows for compensation. Whether this then also applies when the compensation is paid directly by the foreign global distributor to the Swiss distributor while bypassing the representative is doubtful. Of course, the representative could get this information. However, it makes no sense to require this from a representative when the investor can also get this information from the distributor, to whom he is much closer.

6. The mandatory record keeping
Licensees and third parties included in the sales are now subject to mandatory record keeping of the customer discussions (art. 24 para. 3 revCISA). When doing so, both the customer's requirements, as well as the reasons for each recommendation of a certain collective investment scheme must be recorded. As well as the intentions of this condition are meant, it stands equally in conflict with the Swiss legal landscape. It includes namely only the distribution of fund's units but not the distribution of structured products, shares or bonds. This distorts the market through the additional expense for funds' distribution generated through this. Far more meaningful would have been prescribing such an obligation (if at all) for all financial investments in the planned financial services legislation.

A detailed handling of this topic in German language will appear in issue 4/2012 of the Schweizerischen Zeitschrift für Gesellschaft und Kapitalmarktrecht sowie Umstrukturierungen (GesKR).

The amendments, which the revision of the CISA entails in the area of administration and distribution, are treated in a separate publication. You may also find this on our website at www.kellerhals.ch

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