

NEWSLETTER

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From the Investment Fund Act to the Act on Collective Capital Investments

In February 2004, the Swiss Federal Council released for comments the draft of the revised Swiss Federal Investment Fund Act (IFA). The new draft of the "Federal Act on Collective Capital Investments" ("Draft-CCIA" or "Act") aims to strengthen the position of Switzerland within the EU as a distributor and also as a producer of funds.

1 Overview

In order to increase the competitiveness of the Swiss fund business, additional **investment schemes** shall be introduced. In the future, the investment company with variable capital (following the pattern of the Luxembourg SICAV) and the Limited Partnership for Collective Capital Investments (comparable to the Anglo-Saxon limited partnership) shall be available.

Following the "**same business, same rules**" principle, the Draft-CCIA further provides that in principle all forms of collective investment schemes shall be subject to the Act and shall be supervised by the Swiss Federal Banking Commission ("FBC"). This means that the license requirement would not only apply to contractual investment schemes but also, for instance, to the Swiss closed-ended investment company. Furthermore, the Act would extend to investment foundations most of which, until now, have been supervised by the Swiss Federal Office for Social Insurance.

The currently relevant criterion of "**public advertising**" shall no longer be important for the definition of a Swiss collective investment scheme (while remaining applicable for the distribution of foreign collective investment schemes and for in-house funds). The Act defines three decisive criteria. Firstly, an investment must qualify as a **capital investment** which, according to the Swiss Federal Tribunal, is "an investment of money made with the long-term view of achieving a return or an increase in value or at least a preservation of the

investment". Secondly, this capital investment must be made by a **number of investors** and thirdly in a **collective manner**. This shall be the case if the investments are paid into a uniformly managed "common pot" with the effect that the claims of the investors can no longer be individualized but correspond to a quota in a pool of assets.

The Draft-CCIA further introduces the concept of **different investor categories** with "qualified investors" and other investors.

2 Investment Categories of the Draft-CCIA

The Draft-CCIA distinguishes open-ended and closed-ended collective capital investments, depending on whether or not the investor has a right to have its shares repaid at their net asset value.

The "**open-ended collective capital investments**" category comprises investment funds and investment foundations (which will, for the first time, be regulated by law and subject to the supervision of the FBC). Investment funds can be set up as contractual schemes (as has been the case so far) or as corporate schemes in the form of an investment company with variable capital ("Open-ended Investment Company"; see clause 3 below).

Closed-ended collective capital investments include the new category of the Limited Partnership for Collective Capital Investments ("LPCCI"; see clause 4 below), as well as the "Closed-ended Investment Company" (SICAF). The proposed submission of the Closed-ended Investment Company under the Act has been the subject of a number of motions by members of the Federal Parliament and been a matter of controversy for years; the possibility of a potentially more favourable tax treatment may add a new dimension to the discussion (see clause 10 below). The Draft-CCIA provides that Closed-ended Investment Companies shall be admissible in



two forms, either as a public investment company with a mandatory listing, or as an investment company for qualified investors.

According to the Draft-CCIA, investment activities shall be subject to the Act only if they count as a primary activity. The Draft-CCIA provides some guidance and sets out a non-exhaustive catalogue of **legal forms that are not subject to the Act**, such as corporate bodies and establishments of public law, social insurance and compensation funds or operative and holding companies. Difficulties of differentiation may arise with investment clubs or holding companies; in the latter case, the practice of the Admission Board of the SWX Swiss Exchange regarding the Additional Rules for the Listing of Investment Companies may provide some guidance.

Finally, the Draft-CCIA extends the scope of the application of **in-house funds**; these shall continue to be exempt from a license requirement; they will no longer be reserved to banks, but also available to securities dealers. As has been the case so far, the public advertising of in-house funds will not be permitted.

3 Open-ended Investment Company as new Investment Scheme

Following the pattern of the Luxembourg SICAV, the investment company with variable capital shall also be introduced in Swiss law.

The Open-ended Investment Company is based in essence on Swiss stock company law, adapted by the Draft-CCIA to the needs of an investment scheme. This has been achieved by identifying and enumerating the provisions of Swiss stock company law which do not apply to Open-ended Investment Companies or which are not permissible for them, such as the rules on capital increases and decreases.

Two categories of shares shall be introduced for Open-ended Investment Companies, namely founder shares with a nominal value and investor shares with no nominal value. Both carry voting rights, but the right to liquidate the Open-ended Investment Company remains with the sponsor as the holder of the founder shares.

The Open-ended Investment Company is expected to be an attractive investment scheme for promoters of private label funds, primarily independent asset managers, who wish to offer collective capital investments to their own customers but who lack the personnel, financial and organisational resources necessary for the establishment of a fund management company.

4 Introduction of the Limited Partnership for Collective Capital Investments

The LPCCI, following the pattern of the Anglo-Saxon limited partnership, is conceived for investments in risk capital ("private equity") and reserved for qualified investors. It follows to a large extent the rules of the Swiss Code of Obligations governing the (ordinary) limited partnership.

The most important difference between the rules of the Swiss Code of Obligations and those of the Draft-CCIA is that the general partner (i.e. the partner with unlimited liability) of an LPCCI can be a legal entity. In addition, the competition clause has been rescinded for the limited partners and eased for the general partner, who can carry out other activities if these are disclosed and are not contrary to the interests of the LPCCI. The general partner shall not, however, be allowed to be a partner with unlimited liability in more than one LPCCI which restriction is not self-evident.

The Draft-CCIA grants the limited partners the right to inspect the books and accounts at any time and to receive quarterly reporting. The partners have, however, no right of instruction or co-determination with respect to investment decisions.

The life of LPCCIs is limited to twelve years.

5 Investment Regulations

The investment regulations of contractual investment schemes and of Open-ended Investment Companies fall into the existing three categories of securities funds (which correspond largely to the current regulations, given the latest developments in the EU), real estate funds, and other funds. The "Other Funds" category has been subdivided for clarification into "Other Funds for Traditional Investments" and "Other Funds for Alternative Investments" (i.e. into particular hedge funds and funds of hedge funds).

Investment foundations must abide by the investment regulations applicable to pension funds.

No specific investment regulations need be observed by closed-ended collective capital investment schemes, i.e. by LPCCIs and Closed-ended Investment Companies. If, however, a Closed-ended Investment Company applies alternative investment strategies, it must observe the rules applicable to Other Funds for Alternative Investments, in particular regarding the maximum leverage effect and the skills of the personnel.

6 The "Qualified Investor" as new Investor Category

In contrast to the IFA, the Draft-CCIA distinguishes "qualified investors" from other investors.

The term "qualified investor" shall be defined in the implementing ordinance. It seems likely that the definition will be along the lines of the EU prospectus guideline which includes banks, securities dealers and other institutional investors as well as high-net-worth individuals with a securities portfolio of not less than EUR 500,000.

The investment foundation, the LPCCI and the non-listed Closed-ended Investment Company are reserved for qualified investors.

To avoid any misuse, for individual investments, of the term "investment fund" and of the tax advantages they benefit from, the implementing ordinance shall set the **minimal number of (qualified) investors at 20**. This rule shall apply to investments made in the form of a contractual investment fund, an LCPPI and the non-listed Closed-ended Investment Company. If investments are made by "institutional investors with professional treasury management", the minimum number shall remain five in accordance with the current practice of the FBC.

7 Foreign Investment Funds

The license requirements for the distribution of foreign collective capital investment schemes in Switzerland have proved valuable and shall in essence be maintained. This means that securities funds that are EU compatible will continue to be eligible for an abbreviated license procedure.

Along with the broader definition of Swiss collective capital investments, the notion of foreign collective capital investments has also been expanded in the Draft-CCIA and now includes closed-ended investment companies and limited partnerships which are not subject to supervision in their home jurisdiction. These companies shall be subject to the Act if public advertising for them is conducted in or from Switzerland. However, as they are not subject to supervision, a license may not be granted.

As with Swiss collective capital investment schemes, foreign collective capital investment schemes will also have to abide by the rules on performance comparison, on the indication of the total expense ratio ("TER") and on the preparation of a simplified prospectus (see clause 9 below).

8 Structured Financial Products

The official comments on the Draft-CCIA address the difficult distinction between collective capital investments, for which a license is required, and fund-like financial products, which are not subject to a license requirement, such as index certificates, basket certificates and other certificates or structured notes with or without capital protection. In line with present practice, fund-like financial products are typically not subject

to the IFA, since one of the four defining criteria of article 2 IFA has not been met (public advertising, management by a third party, collective investment and segregated funds). Under the Draft-CCIA, fund-like financial products shall also not be subject to a license requirement. The potential investor must be informed of this under the **labelling duty**, if such products are advertised publicly rather than privately. No warning against issuer credit risk, typical for these products, need be given.

The distinction between fund-like financial products and collective capital investments may become even more difficult under the Act due to the extended definition of "collective capital investments". The criterion of "management by a third party" shall no longer be relevant. According to the comments on the Draft-CCIA, the main criterion shall instead be the existence of a "pool of assets". If this is the case, it will have to be determined if the investment in question has been made by the investors in a collective manner, as discussed in clause 1, above.

Pursuant to the comments on the Act, no "pool of assets" shall be considered to exist, if the issuer, for instance, records the proceeds on the liabilities side of its balance sheet and is not obliged to invest these proceeds or to manage them as a segregated investment for the account of the investors, using them instead "for general corporate purposes". However, if the proceeds are recorded as a segregated liability or if a special purpose vehicle is used, the conclusion could possibly be drawn that a "pool of assets" does indeed exist and that a license is required. The distinction between segregated and not segregated liabilities is not entirely logical from the point of view of investor protection.

9 Further important Modifications

The Draft-CCIA proposes to expand the narrow **scope of activities of fund management companies**, (currently limited by the IFA in essence to the management of the fund assets) and to allow fund management companies and Open-ended Investment Companies to offer asset management, advisory and related services.

In addition, **asset managers of collective capital investments** shall be subject to a license requirement. Pursuant to the Act, this shall apply only to asset managers of Swiss collective capital investments. It would also be desirable for asset managers of foreign collective capital investments to be subject to the supervision of the FBC (possibly on a voluntary basis) to enable them to comply with corresponding foreign regulations.

Following the EU regulation, the Draft-CCIA proposes to introduce a **simplified prospectus** in clear, easily understandable language (except for Other Funds for Alternative Investments). This simplified prospectus must be offered free of charge to



potential investors, prior to their subscribing to shares, and must contain a reference to the full version.

It is a sensible development that **changes of the fund regulations** no longer need to be published in full; the publication of a summary with an indication of where the changed fund regulations may be obtained will suffice.

It is proposed that additional information also be published, such as the indication of the **total expense ratio (TER)**, a **performance comparison** with a benchmark (if any), the names of the asset managers, any change of members of the management of the fund management company and information on pending litigation.

In addition, **payment and redemption in kind** shall be possible, with the consent of the FBC, for all collective investment schemes, which shall not be limited to funds for qualified investors.

10 Adaptation of the tax parameters

The present regime of direct taxes for investment funds is based on a **transparent system** where the fund is not subject to direct taxation and where the income and assets are taxable at the level of the investor only. This system shall be introduced for all collective investment schemes, notably for Open-ended Investment Companies and Closed-ended Investment Companies.

Income from collective capital investments continues to be subject to the Swiss anticipatory tax (**withholding tax**) of 35 per cent. As has been the case so far, funds with a foreign income of more than 80 per cent may settle the anticipatory tax in accordance with the affidavit procedure if payments are made to investors abroad. For practical reasons, the applicability of this procedure continues to be unresolved for growth funds.

11 Outlook

The period for comments on the Draft-CCIA ends on April 30, 2004. Thereafter, the comments will be analysed, the draft Act will be revised, and a Report to the Federal Parliament will be prepared. It is fair to assume that the new Act will only enter into effect in a few years' time.

Due to the conception of the Act as a framework law, attention will have to be paid to the implementing ordinances of the Federal Council and the FBC as supervisory authority.

Contacts

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