SWITZERLAND

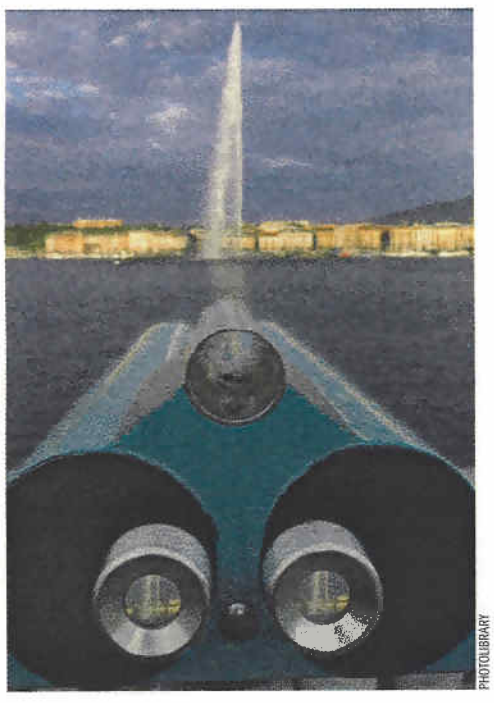
Fund-friendly?

Switzerland is looking to new fund legislation to put the country firmly on the map as a leading financial centre. By Eric Stupp

A major remodelling of Swiss fund legislation is planned to come into force on 1 January 2007. The declared purposes of the new Act on Collective Capital Investments are:

- re-establishment of the competitiveness of Switzerland as a financial centre for funds;
- adaptation to the Undertakings for the Collective Investment of Transferable Securities (Ucits) guidelines of the EU; and
- improvement of the level of investor protection through more strict disclosure rules.

The need for a change of the Swiss legal fund landscape is apparent – the biggest investment fund promoters in Luxembourg are Swiss banks and it is a safe assumption that many of their funds would have been set up under Swiss law had the regulatory regime been more attractive.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The new structures

The new act gives more flexibility on how to structure a collective investment scheme. The scope of the new law will cover certain corporate structures. The act distinguishes between openended and closed-ended collective capital investments schemes, depending on whether the investor has a right to have their shares repaid at their net asset value. The openended collective capital investments category consists of contractual investment funds and investment companies with variable capital. Closed-ended schemes include the category of limited partnership for collective capital investments as well as the closed-ended investment company with fixed capital (SICAF).

It is important to note that a SICAF is not subject to the act if the shares of the company are listed on a Swiss exchange or if only qualified investors are accepted as shareholders. As a result such schemes do not have to register as an investment scheme under the new act. All other Swiss investment companies with a purely collective investment purpose will have to register.

Qualified investors

The new act introduces the concept of a 'qualified investor'. To a degree the Swiss Banking Commission already accepts this concept, even though no clear legal basis exists; but the act provides a clear statutory basis for a differentiation based on the sophistication of the investors. The term 'qualified investor' applies to:

- supervised financial intermediaries, such as banks and securities dealers;
- supervised insurance companies;
- state-owned/controlled entities and pension funds with professional finance departments;
- high-net-worth individuals; and
- investors who are linked contractually with a financial intermediary based on a written asset management agreement.

The ordinance to the new act may even extend this list. In particular it will clarify the thresholds for the qualification as a high-net-worth individual. The present draft of the ordinance provides that an individual is deemed to be a high net worth person if they possess financial assets of at least SFr5m (£2.14m).

Investment schemes that are open for qualified investors only benefit from various alleviations. Pursuant to the draft ordinance, certain categories of openended collective capital investments schemes, such as securities funds and real estate funds, are deemed to be approved by the authorities one day after an application has been filed. Presently the Swiss Banking Commission is unable to compete in terms of timing with the well-staffed and business-orientated regulator in Luxembourg.

The application process will not only be shortened for qualified investor funds, but also for all other collective capital investments structures that target the wider investor community. The envisaged timelines foreseen in the draft ordinance are four and eight weeks respectively for the licensing process.

Exemption for structured products

There has been intense lobbying surrounding whether the structured product market should be regulated, but finally the regulator decided to have such products exempted from the act and therefore from any licence requirement. The following criteria have to be met in order to qualify for the exemption:

- if the product has been issued, guaranteed or distributed by a Swiss-supervised bank, insurance broker or a foreign financial institution with an equivalent supervision;
- if a simplified prospectus exists that mentions the main terms of the structured product and that is understandable for an average investor; and
- if the prospectus mentions that the product is not subject to regulatory oversight.

The simplified prospectus format that has to be used for structured products will have to meet the minimum requirements accepted by the regulator. The draft ordinance is even more restrictive than the new act with respect to foreign banks. Only a foreign-supervised financial intermediary with a subsidiary or affiliate in Switzerland may advertise publicly and actively market structured products in Switzerland. In practice this means that many foreign financial intermediaries will have to rely on Swiss banks for distribution of their products.

Insufficient tax reform

Unfortunately the Swiss legislator was not ready to initiate a sweeping modification of the applicable tax rules. The present regime for investment funds is based on a transparent system where the scheme is not subject to direct taxation. With the exception of real estate investment funds, the income and assets are taxable at the level of the investor only. This regime will remain. Consequently, distributions of the investment scheme to foreign investors or a redemption of the shares are subject to a tax rate of 35 per cent. The foreign investor may reclaim, partially or in full, the tax pursuant to the applicable double taxation treaties if they fulfil the respective criteria.

Licensing requirements for foreign collective capital investment schemes

The new act does not overhaul the present regime for foreign investment schemes. Foreign collective investment schemes need a licence from the Swiss Banking Commission if their shares are advertised publicly in or from Switzerland. The draft ordinance provides important clarifications with respect to public advertisement of foreign funds. Advertisement is not deemed to trigger the licensing requirements if it solely targets qualified investors and uses common advertisement channels. Furthermore, the publication of prices in the media does not qualify as public advertisement if it contains no contact details.

Luxembourg – ahead of the game

It is not very likely that the new Act on Collective Capital Investments will allow Switzerland to restore its position in the fund industry. First, the detrimental tax regime remains. Second, Switzerland has no agreement in place with the EU implementing the *Cassis de Dijon* principle, under which a Swiss collective capital investments scheme would benefit from the rules of Ucits III, in particular the EU passport regime. Finally, Luxembourg has a competitive advantage in terms of a well-established fund service industry, as well as a rapid regulator. The new act is nevertheless a major step in the right direction. If further changes will be made with regard to the tax treatment of such structures in the future, Switzerland may be in a position to regain part of the market share. ■

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