

Update

Newsflash April 2021

Draft legislation for a new unregulated fund category in Switzerland

On August 19, 2020, the Federal Council submitted a draft legislation to Parliament, pursuant to which a new unregulated fund category for qualified investors, the so-called Limited Qualified Investor Fund ("L-QIF"), is introduced by way of a formal amendment to the Collective Investment Schemes Act ("CISA"). This draft legislation will now be discussed in Parliament, the competent Commission of the Council of States having performed a first review on April 20, 2021.

1. Background

In June 2019, the Federal Council initiated consultation proceedings to evaluate the interest of the industry in introducing a new legal framework in Switzerland for a new category of funds for qualified investors, with significant flexibility in terms of investment policy and restrictions, and with no authorization, approval or direct supervision by the Swiss Financial Market Supervisory Authority ("FINMA"). On April 20, 2021, the Commission for Economic Affairs of the Council of States has performed a first important review of this draft legislation.

For an overview of the key issues discussed during the consultation proceedings, please refer to our previous newsflash of September 2019 (<https://www.lenzstaehelin.com/en/publications/newsletters/detail/proposal-for-an-unregulated-fund-category-for-qualified-investors-4703>).

2. Purpose and concept

The L-QIF is intended to meet the needs of the Swiss institutional market participants, which commonly use collective investment schemes to pool their assets. The L-QIF may also suit the needs of Swiss banks and fund investment managers to tailor investment funds to the specific needs of high-net-worth individuals. It is inspired by the success and experiences of foreign investment funds, such as the Luxembourg Reserved Alternative Investment Funds ("RAIF").

One of the key goals of the legislator is to reduce the regulatory burden for the launch of investment funds and, as a consequence, to enhance Switzerland as place of establishment of funds. The L-QIF is also expected to encourage innovation in the field of funds and, accordingly, to strengthen the competitiveness of Switzerland's asset management industry.

The legislator is also proposing specific amendments to the tax legislation to ensure that

L-QIFs benefit from the same tax regime as other fund categories, including as regards tax transparency and real estate taxes. The application of the same tax rules to L-QIFs as for other Swiss regulated collective investment schemes is a key element for the success of this legislative project.

The L-QIF will not be regulated by a separate legal framework, but by new provisions in the CISA, which will serve as legal basis for this specific category of collective investment scheme. The draft rules define the L-QIF as a Swiss collective investment fund which is (i) exclusively reserved to qualified investors, (ii) not subject to FINMA authorization, approval or supervision, and (iii), as a rule, managed directly or indirectly by a FINMA supervised fund management company (with exceptions for limited partnerships for collective investments ("LPCI")).

Eligible Investors

The definition of qualified investors under CISA includes not only professional and institutional clients under the Swiss Financial Services Act ("**FinSA**"), but also certain private clients, which have not refused to be treated as such and have entered into a discretionary or advisory agreement with a Swiss bank or another financial intermediary supervised by FINMA under the Swiss Financial Institutions Act ("**FinIA**"), with a non-Swiss financial intermediary subject to an equivalent prudential supervision, or with Swiss insurance companies and have not opted-out of the status of qualified investors. Professional investors under FinSA include in particular financial intermediaries, insurance companies, pension funds, companies with a professional treasury, large companies, as well as high-net-worth individuals requesting to be treated as professional clients.

Legal Form and Delegation Rules

The L-QIF is not a new legal form of Swiss funds. Rather, any of the existing open-ended collective investment schemes (i.e., contractual fund or SICAV) can be used as a basis for a L-QIF. As regards closed-ended funds, the Federal Council has, as a result of the consultation proceedings, excluded SICAFs from

being eligible to be used as L-QIF and limited the available closed-ended L-QIF structure to the LPCI.

The absence of FINMA approval, authorization and supervision over the L-QIF will be balanced by the following elements:

- › L-QIFs in the form of contractual investment funds will need to be managed by a FINMA regulated fund management company (which may in turn delegate the asset management to regulated managers of collective assets).
- › L-QIFs organized in the form of a SICAV will need to delegate their administration and the asset management to FINMA regulated fund management companies (which, again, may delegate its investment decisions to regulated managers of collective assets). L-QIFs can thus not take the form of self-managed SICAVs.
- › L-QIFs organized in the form of a LPCI will have to delegate their administration and the asset management to a FINMA regulated manager of collective assets, but not necessarily to a FINMA regulated fund management company based on the reasoning that a fund management company does not necessarily have the expertise to administer and manage a LPCI. An important exemption to this rule has been introduced as a result of the consultation proceedings, namely that the obligation to delegate the administration will not apply to LPCIs if its general partner is licensed as a Swiss bank, securities firm, manager of collective assets or insurance company. This aims at encouraging such institutions to launch L-QIFs in the form of LPCIs.
- › The delegated entities to which the L-QIFs refer will have a special obligation to provide for the necessary organization and processes to meet the test of an irreproachable business conduct, including for the performance of the tasks delegated to them by the L-QIF.

3. Investment Policy and Transparency Requirements

L-QIFs will not be subject to any of the CISA requirements regarding permitted investments or

investment restrictions. The eligible investments are, as a rule, intended to cover any assets, whether traditional or alternative. In this context, L-QIFs will for example be permitted to invest in any financial instruments or real estate assets as well as in infrastructure, commodities, digital assets (such as cryptocurrencies), or in any other assets such as wine, artwork or vintage cars. As regards real estate assets, concerns have been raised that a L-QIF, investing directly in real estate, in which private investors would be eligible to invest, may lead to a risk of a circumvention of the relevant Swiss tax rules applicable to real estate. For this reason, the Commission of Economic Affairs of Council of States proposes to restrict the investments by private investors in L-QIFs having direct real estate holdings.

It is expected that the Federal Council will address, in the implementing ordinance (CISO), details on the permitted investment techniques and restrictions. As FINMA will not supervise L-QIFs, no specific regulations are expected to be included in the CISO-FINMA, which contains detailed provisions on the use of derivatives, securities lending and repo transactions for regulated funds.

An open question relates to the role of the custodian for assets other than transferable securities, which are as such not capable of being kept in custody by a bank under CISA, such as commodities or infrastructure. This will most likely require the inclusion of specific provisions in the implementing ordinance (CISO).

To balance this rather liberal and flexible regime, the new regime will provide for the responsibility of the fund management company or the SICAV to ensure at all times the liquidity of the portfolio to meet investors' redemption requests. This will not only apply to open-ended L-QIFs, but to all open-ended Swiss contractual schemes, and will increase the responsibility of the delegated institutions, assuming the management of the assets of L-QIFs. In this context, the Commission for Economic Affairs of the Council of States proposes to introduce a significant flexibility, which would allow open-ended L-QIFs to limit redemption rights for a period exceeding five years, always subject to the ultimate responsibility of the Fund

management company to ensure the liquidity of the portfolio.

Also, the draft CISA focuses on the transparency towards the investors in the L-QIF documentation as well as on adequate risk warnings. While a L-QIF will also be authorized to invest in assets which can be targeted by a FINMA regulated Swiss collective investment scheme, the documentation will have to clearly refer to the fact that the fund is a L-QIF and bear a disclaimer as regards the absence of FINMA supervision. Also, SICAVs and LPCIs will have to include the term "L-QIF" in their name. No L-QIF will be allowed to refer in its name to any of the categories of the regulated funds, such as real estate fund or other fund for traditional or alternative investments under CISA.

Specific rules are included for L-QIFs organized as real estate investment funds in addition to the restriction for private investors to invest in L-QIFs directly holding real estate. For those real estate L-QIFs, the specific duties of loyalty generally applicable to Swiss real estate funds will also apply, including namely the prohibition to enter into transactions with closely related persons unless a specific exemption applies. Also, rules will apply as regards the number of valuation experts and their independence (Art. 118b draft CISA).

4. Documentation

The new legislation will expressly exempt L-QIFs from the requirements to produce a prospectus and a key information document. The fund documentation of a L-QIF will be the sole responsibility of the fund management company for contractual L-QIFs. The consent of the custodian will have to be obtained in advance to this effect and also for any subsequent amendments to the documentation.

The documentation of L-QIFs will have to provide references to the institutions to which the administration and the asset management is delegated.

As regards the investment objectives and restrictions, the same will have to be set out in detail in the fund contract for contractual funds, the investment regulations for SICAVs and in the

partnership agreement for LPCIs. In case of alternative investments, specific risk warnings will have to be included.

5. AML

It is worth noting that L-QIFs organized as a SICAV or LPCI will be exempt from the Anti-Money Laundering Act and from the related registration with a self-regulatory organization, provided that the institution responsible for the management of the L-QIF ensures compliance with AMLA obligations.

6. Assessment and Conclusions

The proposed L-QIF has shown a rather positive feedback from the Swiss asset management industry for the L-QIF project. Only few reluctant voices have been raised, mainly motivated, on the one part, by the concern that the absence of supervision may compromise the protection of private investors or pensions funds and, on the other part, on the specific risk of potential circumventions of the relevant tax laws for L-QIFs, open to private investors and directly investing in real estate.

Most concerns raised during the consultation proceedings have been accommodated in the draft legislation submitted to Parliament. This holds in particular true for (i) the facilitated delegation of the administration by an L-QIF to a FINMA licensed asset manager of collective assets (rather than to a FINMA regulated fund management company, as provided in earlier drafts), (ii) the substantial extension of the scope of financial institutions, which will benefit from facilitated rules for the administration of L-QIFs in the form of a LPCI, (iii) the confirmation that L-QIFs will be subject to the same tax regime as any other Swiss collective investment scheme, and (iv) the admissibility of real estate L-QIFs under the Swiss regulation governing the acquisition of real estate by foreigners, as well as (v) the exclusion of the delegation of the asset management decisions back to a single investor,

which is not supervised. The last point may reduce the interest of many pension funds and other tax-exempt institutions, which otherwise may have had a significant interest in a L-QIF, to use this structure for so-called "single investors funds", which play a significant role in Switzerland for such institutional investors. Finally, the restriction, which is now proposed as regards investments by private investors into L-QIFs, directly holding real estate, should answer the concerns as regards the risk of potential circumvention of tax laws. This is however not expected to materially affect the significant interest of investors for L-QIFs.

7. Next steps

With the introduction of L-QIFs, innovative Swiss funds could be launched much faster and in a cost-effective way. More information on the attractiveness of the L-QIFs as a new form of investment in Switzerland, will be available once the consultation process for the implementing ordinances to the new legislation will be launched, which is expected to occur by the end of this year. Once the new legislation is finally adopted, this would represent an important step towards responding to the needs of the Swiss institutional market, but also of wealth management and private banks, wishing to set up L-QIFs for other professional investors, whilst improving the attractiveness of Switzerland as a leading asset management center, the current COVID-crisis has impacted the work of the Parliament on the new legislative proposal, with some delay in the process. If the draft legislation is adopted by the Parliament, the new rules on L-QIFs together with the relevant rules at the level of the CISO, could enter into effect, if not as early as on July 1st, 2022, as initially expected, but at the latest on January 1st, 2023.

Please do not hesitate to contact us in case of any questions.

Legal Note: The information contained in this UPDATE Newsflash is of general nature and does not constitute legal advice. In case of particular queries, please contact us for specific advice.

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