



Swiss Representation

Promoters to note new distribution requirements

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In March 2013 Swiss authorities tabled amendments governing the distribution of non-registered funds. The category of non-registered funds includes foreign-domiciled hedge funds, private equity, real estate, etc. Essentially the regulation, amongst other things, requires every non-registered fund distributed in Switzerland to appoint a representative who is responsible for ensuring the marketing of the fund is in compliance with the law. The potential target market of professional and experienced investors now referred to as Qualified Investors has also been defined, and it is now a requirement that distributors of the funds are regulated and the fund appoints a paying agent. Compliance of a fund with the law is mandatory from 1 March 2015 if any offering activities are being conducted to certain categories of Swiss investors, including pension funds, HNWI and private wealth managers, whether they be existing investors or new prospects.

Funds authorized for sale in Switzerland, either Swiss-domiciled funds or UCITS funds approved for distribution, have always been required to appoint a Swiss Representative and Paying Agent, so the new rules ensure a certain consistency. It should be noted that non-registered funds may only be offered to Qualified Investors and therefore the overall regulatory requirements are much lighter for this category of funds.

The traditional providers to registered funds have either chosen not to offer representation to non-registered funds or to build expertise in the area. Given the risk accepted by the Representative, specific experience in alternatives is necessary. The question is *how to assess the inherent risk of acting as a Swiss Representative*. The law is clear as to the functions FINMA requires the representative to fulfill; they are ultimately responsible for insuring that all distribution of the fund is in compliance with the rules related to foreign funds distribution in Switzerland. However, liability through association with the wrong fund/promoter/distributor is difficult to assess; this would be based on civil litigation if something did go wrong. Whilst insurance is a FINMA requirement, extensive reputational damage accompanied by legal action could destroy the business.

Representatives therefore need to make sure they understand the investment strategy of the fund, ensure this is accurately described in the legal and marketing materials and that the materials are fair, clear and not misleading. They need to assess whether the terms of the structure are appropriate for the strategy and securities being traded.

Representation is a compliance function, and expertise in compliance and legal is a must. A further requirement is that the Representative needs to be able to help the distributor define and qualify the

target investor base; therefore experience in the distribution of alternative funds in Switzerland is another key ingredient.

To date the *state of competition* in the representation market has expanded; the traditional providers have now been joined by a number of new licensees with backgrounds in alternative investment and distribution and who are purely focused on representation of funds that are offered to Qualified Investors only.

Given that representatives are being paid to accept the risk of the fund/promoter/distributor's actions, in theory the *pricing* for the service should reflect the assumed level of risk. A large fund which is actively marketed and follows a complex investment strategy in a complicated structure should be more expensive to represent than a simpler investment proposition with limited marketing in Switzerland. However, we are seeing a fairly consistent spread of pricing from the different providers. Perhaps more relevant is that many of the providers are clear as to the types of funds they will or will not represent.

The *market reaction to the new rules* has been interesting. Pre-September compliance and legal departments were overloaded with acronyms and probably could not think about the issues particular to Switzerland. The July deadline for AIFMD has passed and, as the relevant people emerge from the decisions and subsequent actions, the Swiss rules are now on the agenda. Prior to meeting with the support side of the business, we spend time with the marketing team to discuss Swiss focus. Having spoken to over 100 different managers/promoters in the last eight weeks, we can generalize the comments by location.

Discussions with US-based managers typically have been with those who do not offer UCITS funds. The overriding comments on European distribution are that they are following the National Private Placement Regimes in the UK and a few other Northern European countries. AIFMD is not being actively pursued. The early comment was initially "we are going to rely on reverse solicitation". The increase in articles published by a number of prominent scribes in the legal profession has resulted in less confidence in the reverse solicitation approach. Given that the vast majority of those managers we have approached have existing Swiss investors, the costs of compliance do not require a meaningful analysis of the future opportunity set. UK and European-based managers have been focused on registering as AIFMs. As most have Swiss investors they have resigned themselves to accepting the need to appoint Swiss Representatives and Paying Agents without too much complaint. For Asian-based managers, the decision to market in Europe and Switzerland is still uncertain,

and while there is a desire to understand the issues, there is more of a cost benefit analysis going on.

In general we have had very few discussions around the "exempt" category of *Qualified Investor*. Funds purely focused on this type of investor are not required to appoint a Swiss Representative and Paying Agent. This category is limited in particular to FINMA-regulated insurance companies and the discretionary accounts of FINMA-regulated fund managers and banks. Whether the FINMA-regulated banks are holding the position pursuant to a discretionary or advisory mandate is difficult to ascertain. A prominent Swiss private bank has recently informed all the managers on their recommended list that they will be expected to appoint a Swiss Representative and Paying Agent. This helps everyone to make the decision. It seems that the exempt Qualified Investor market is generally perceived to be a small part of the Swiss target investor base as the marketing focus tends to be on the family office, pensions funds, HNWI, or private wealth market that Switzerland is known for.

In general, the feedback as to the *Swiss approach to distribution has been seen as pragmatic*. Requiring every fund and promoter to have an anchor point in Switzerland and ensuring the offering is restricted to experienced and professional investors is reasonable. The revised legislation effectively allows for alternative managers to continue their activities but with the same representation required by registered funds. Potential fund promoters are pleased that the rules do not require extensive reporting, which is a criticism of AIFMD and NPPR.

Negative feedback centres on the *role and justification for a paying agent*. The paying agent must be a Swiss Bank. It is appointed by the fund to allow any investor to subscribe, redeem or receive any proceeds locally. It is a regulatory requirement that the fund offers this capability should a Swiss-based investor require it. The consensus and the practice in the registered fund sector is that investors will continue to rely on the fund's custodian and administrator to subscribe and redeem, and practically the paying agent will have little to do. Aside from the cost of the service, which is fairly nominal for larger funds, the number of banks willing to act as paying agents is limited. They believe the low return does not compensate for the reputational risk of association with the "wrong" fund. However, we are beginning to see a number of banks reconsider offering this paying agent service.

To summarize, realization has sunk in that steps need be taken to ensure client service and distribution in Switzerland can continue uninterrupted, and funds are in the process of identifying their service providers. We suspect that the activity will accelerate to the February 2015 deadline. **THFJ**