

New regulation eases investment

Christoph Heiz, Alexander Vogel and Thomas Ladner of Meyer Lustenberger outline Switzerland's flexible new regulations for private equity investments

The new Swiss Federal Act on Collective Capital Investments (CCIA) came into effect on January 1 2007 and has replaced the former regulations on investment funds. In view of the increased competition among the international financial markets, the CCIA is designed to enhance the competitiveness of the Swiss market for collective capital investments. The new law has been modified to bring it into line with EU regulations and has been extended to provide new attractive schemes of collective capital investments and apply these rules to schemes that so far have not been regulated.

The Collective Capital Investment Act

The former Swiss investment fund laws permitted exclusively open-end investment funds based upon a collective investment agreement entered into by the fund management and the custodian bank with the investors. This was the only type of investment fund to come under the supervision of the Swiss Federal Banking Commission (FBC), entitled to use the term *fund* in its name and to publicly solicit *fund* investors. Although other types of collective capital investments vehicles, such as closed-end investment companies, existed, they were not subject to the former Swiss investment fund laws. Modern forms of collective investment schemes such as Sicavs or LPs did not exist at all.

This restricted scope of the former investment fund laws was a big disadvantage for the Swiss fund and private equity industry, which to a large extent has been eliminated by the CCIA. The CCIA provides now a comprehensive set of rules regulating the supervision of collective investments applicable to the following types of collective capital investments:

- **Open-end** collective capital investments comprise investment funds based upon a collective investment agreement (as under the former Swiss investment fund regulations) and of investment companies with a flexible capital (*société d'investissement à capital variable*, Sicav).
- **Closed-end** collective capital investments are organized as either a limited partnership (LP) for collective capital investments or an investment company

with fixed capital (Sicaf).

However, some forms of collective capital investments are not subject to the CCIA. The new law does not apply to investment companies whose shares are either traded at a Swiss stock exchange or held by qualified investors only. Nor does it apply to operating companies, holding companies or investment clubs whose members are in a position to independently administer their interests. Further, pooled assets (internal funds) set up by banks or security dealers for the collective investment and management of their client's portfolios do not fall within the scope of the CCIA and the supervision of the FBC if: (i) the clients participate in the portfolio based upon a written asset management agreement; (ii) no shares are issued; and (iii) no public advertisement is made. These internal funds are, however, supervised by the bank's independent auditors and must be managed pursuant to the regulations issued by the FBC.

New legal forms for collective investment

The Sicav and the LP for collective capital investments are new investment vehicles under Swiss law. The Sicav is based upon the legal concept of a Swiss stock corporation (*société anonyme*). The main differences between the Sicav and the stock corporation regard share capital and the shares. At the formation of the Sicav, a minimum capital contribution of SFr250,000 (\$205,000) is required to be paid in by the so-called entrepreneurial shareholders. Further, the Sicav may issue so-called investor shares to the investor shareholders against payment of capital contributions. These capital contributions do not have the function of share capital of a stock corporation and the rules on capital protection

that are characteristic for the stock corporation do not apply to the Sicav. As the Sicav is allowed at any time to issue new shares and the shareholders are allowed to redeem their shares, the Sicav does not have a fixed share capital. The issuance and redemption of Sicav shares have to be made at their net asset value. In line with the EU Investment Services Directive, the CCIA provides for two forms of Sicav – the self-managed Sicav and the Sicav managed by a third party asset manager. A Sicav delegating its management to a third party asset manager does not have to fulfil any further requirements relating to its organization, while the asset manager needs to be an authorized fund manager subject to FBC supervision. In a self-managed Sicav, the management team is responsible for the asset management, so the Sicav needs to assure that the individual managers have the necessary formation, experience and reputation to serve as officers of the Sicav.

A second new investment form introduced by the CCIA is a form of limited partnership designed for collective capital investments in risk capital. The LP for collective capital investments resembles the characteristics of the Anglo-Saxon limited partnership. This new investment vehicle is primarily designated for investments in risk capital so it is particularly appropriate for private equity investments (equity, mezzanine, debt), but can also be used for collective investments in construction and real estate projects or alternative investments. Investors in a LP for collective capital investments need to be qualified investors.

While, in general, the rules governing this investment form are similar to those of the Swiss Code of Obligations governing the (common) limited partnership, there is an important difference: the general partners of a common limited partnership have to be individuals and are as such subject to unlimited liability. Under the CCIA, however, the partners subject to unlimited liability must be organized in the form of a stock corporation with a registered office in Switzerland and a paid-in capital of at least SFr100,000. The stock corporation is responsible for the management of the LP, but is only allowed to act as general partner in one limited partnership. The general partner is allowed to carry on other activities if these are fully disclosed and do not conflict with the interests of the LP. The limited partners are excluded from the management of the LP.

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Author biographies



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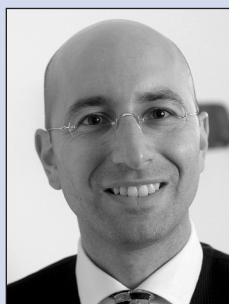
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They may not decide on certain investments, nor may they veto investment decisions. Conversely, the limited partners are entitled to inspect the accounts of the LP as well as to receive quarterly reporting and are not subject to a covenant not to compete.

The rights of the parties to the agreement are set out in the partnership agreement, which has to include certain minimum provisions set out in the CCIA. The statutory maximum duration of a LP is limited to 12 years. After one year from the launch date (at the latest), at least five limited partners must be invested in the LP.

The LP is subject to FBC approval and supervision, that is, before launching a LP, the partnership agreement needs to be submitted to the FBC for approval. The same applies to material changes to the agreement after the launch. The partnership agreement also needs to be filed with the competent register of commerce, which will then register the LP. Further, the LP under the CCIA needs to have its accounts audited and so needs to appoint a statutory auditor. Also, the general partner needs to obtain a licence from the FBC as an asset manager, for which similar conditions to those applicable to a fund manager apply (see below). The general partner is allowed to delegate certain

administrative tasks as well as the asset management fully or partially to a third party asset manager. The LP accounts have to be established in accordance with the provisions of the CCIA and its implementing regulations. The LP can use another currency than Swiss francs for reference, valuation and accounting purposes.

The two newly created investment vehicles, Sicav and LP, are both tax-transparent, that is, capital gains and dividend or interest income are not taxed on the level of the Sicav or LP, but attributed proportionately to the partners. Dividend income and interest income is further subject to withholding tax, unless certain exceptions apply. The taxation of the carried interest, that is, the general partner's share in capital gains, and certain related value-added tax issues are still debated. The subscription of an interest in a LP is not subject to stamp duties.

Exemptions for Sicaf

Under the former regulations on investment funds, Sicafs were not subject to FBC supervision and asset managers of a Sicaf did not need a licence to render their services. According to the provisions of the new Act, both are now subject to approval and/or licence requirements and are subject to the

general supervision of the FBC. There are two important exceptions: Sicafs are exempt from the regulations and supervision provided for in the CCIA if they are either: (i) listed on a stock exchange in Switzerland; or (ii) if they have only registered shares outstanding, only qualified investors are allowed to acquire shares and an accredited auditor confirms fulfilment of these conditions on an annual basis. A number of investment companies consider going public or transforming either into a Sicaf restricted to qualified investors or a mutual fund.

Qualified investors

Like other jurisdictions, the CCIA defines the term of a qualified investor. This term comprises institutional investors, including banks, insurance companies and pension funds but also high-net-worth individuals that hold directly or indirectly financial assets of at least SFr2 million or investors who have concluded a written discretionary asset management agreement with a qualified asset manager. This threshold has been debated, because a higher amount would have been unnecessarily restrictive (also for the placement of private equity investments). The CCIA recognizes that qualified investors do not need the protection required for other investors. As a consequence, the FBC is authorized to relieve collective investment vehicles from certain requirements if the circle of investors exclusively consists of qualified investors. In particular, based upon exemptions granted by the FBC, the collective investment entity may not be required: (i) to grant the investors the right to redeem the shares or units and to terminate their investments at any time; (ii) to issue or redeem the shares in cash; (iii) to strictly apply the principle of risk diversification; and (iv) adhere to all the information duties. Also, investment companies organized in the form of stock corporations are not subject to the CCIA if the articles of incorporation only allow qualified investors to hold shares, the company issues only the registered shares and a recognized auditor issues a yearly confirmation that these requirements are fulfilled.

Authorizations

Before starting any activity, an authorization from the FBC is required for any collective capital investment entity (investment fund, Sicav, LP, Sicaf), the fund management, the custodian bank, the portfolio manager, the sales representative of a collective capital investment, and the representatives of foreign funds. The FBC grants an authorization if the persons responsible for the management of the funds have an impeccable reputation and the required professional qualifications. Further, the investment vehicle needs to set up an organization that is appropriate to fulfil the legal duties and to cope with the investment risks. In the authorization procedure, the FBC approves in particular the collective investment agreement of the investment fund, the articles

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of incorporation and the investment regulations of the Sicav, the partnership agreement of the LP, and the corresponding documents of foreign collective capital investment vehicles.

Foreign collective capital investments

The public solicitation and distribution of foreign collective capital investments are subject to an authorization by the FBC. In the authorization procedure, the relevant documents, such as offering memorandum, articles of incorporation or fund agreement have to be submitted and will be examined by the FBC.

Authorization will be granted if:

- the collective investment at the place of incorporation of the fund management or the company is subject to the supervision of a public authority aimed at the protection of the investors;
- the fund management or the collective investment company is subject to comparable requirements with respect to its organization, the rights of investors and

the investment policy;

- the name of the investment vehicle is not misleading and does not give rise to confusion;
- if a representative and a Swiss bank acting as payment agent are appointed.

The representative represents the foreign collective investment company regarding the investors and the FBC. It is responsible to fulfil the statutory notification, publication and information obligations and its identity must be disclosed in each publication. Any restriction of the representative's authority is not allowed.

Public solicitation

The CCIA considers solicitation to be any advertisement that is directed to the public, such as advertisements in newspapers, mass mailings and internet sites. The CCIA does not contain a safe-harbour threshold to determine whether a solicitation is public, so it is not clear whether the former threshold (which considered solicitations of up to 20 (non-qualified) investors to be a private placement) will still apply. However, any promotional

documents exclusively directed to qualified investors are not considered to be public. The publication of current prices, quotes and net asset values is not considered to be a public solicitation if the publication does not contain any contact details (such as addresses, telephone numbers or links to websites). Under the former Swiss investment fund law, the element of public solicitation was part of the definition of an investment fund, but this criteria is, under the CCIA, only important with respect to the internal (bank) funds and foreign collective capital investments. Internal (bank) funds are not allowed to make any public solicitation, but foreign collective capital investments will become subject to the CCIA as soon as they are publicly distributed or solicited in Switzerland.

Outlook

The CCIA contains a more flexible and dynamic regulation of the private equity and investment fund market. It remains to be seen whether this new law, and the accompanying tax rules, are flexible enough and what their combined effect will be.

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