

FINANCIAL MARKETS BRIEFING

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Issuance and Distribution of Structured Products – New Rules for Switzerland

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Structured products – such as reverse convertibles, certificates and leverage products – are, to a certain extent, governed by the Act on Collective Investment Schemes (“CISA”) and the Federal Ordinance on Collective Investment Schemes (“CISO”).

Both, the CISA and the CISO have recently been amended and will, in their revised version, enter into force on 1 March 2013. Although no authorisation is required, the structured products must meet certain requirements for the distribution in Switzerland.

1. What is new under the revised CISA?

The main changes concern the following three aspects:

a) Under the existing legal regime, the offering of structured products is only governed by the CISA, if the structured products are “publicly offered” in or from Switzerland. An offering is considered to be “public” if the structured products are offered to non-qualified investors (so-called qualitative safe harbour rule) and/or a small group of investors (so-called quantitative safe harbour rule).

Under the new rules, the concept of public offering has been replaced by the following concept: An offering of structured products is only governed by the CISA if it constitutes a *distribution* of structured products to *non-qualified investors*. “Distribution” is a defined term (see 3. below). Further, the definition of “qualified investors” has become more restrictive (see 4. below). Also, it is uncertain whether the quantitative safe harbour rule, which related to the public element, still applies under the new legal regime.

b) Under the existing legal regime, structured products may only be publicly offered in or from Switzerland if they are issued, guaranteed or distributed by either (i) a Swiss bank, insurance company or securities dealer or (ii) a foreign institution that is subject to equivalent standards of supervision, provided that it has a branch in Switzerland or the structured products are listed on a Swiss stock exchange, which ensures the same transparency as a simplified prospectus pursuant to the CISA (such as the SIX Swiss Exchange) (each a “**Recognized Issuer**”).

Pursuant to the revised CISA, the *distribution* by a Recognized Issuer will be no door-opener to the offering of structured products in or from Switzerland anymore: Structured products may only be distributed to non-qualified investors in or from Switzerland if they are *issued, guaranteed or secured in a similar manner* by a Recognized Issuer.

c) Subject to certain exceptions, under the existing and new legal regime, a simplified prospectus has to be made available to the investor at the time of issuance of the structured products. The revised CISA additionally provides that also a *preliminary simplified* prospectus has to be made available to the investor prior to the subscription of the structured products (see 2. below).

2. What action needs to be taken, and by when?

If the offering of, or advertisement for, the structured products will be deemed a distribution to non-quali-

fied investors within the meaning of the revised CISA (see 3. and 4. below) the following actions need to be taken:

- Structured products that have been issued before 1 March 2013 may only be distributed to non-qualified investors in or from Switzerland, if they have been issued, guaranteed or secured in a similar manner by a Recognized Issuer. Specific rules apply to structured products that are issued by a special purpose vehicle (see 6. below). Accordingly, all distribution activities that do not fulfil these requirements have to be ceased before 1 March 2013. However, the new definition of “qualified investors” only applies as of 1 June 2013.
- Structured products that will be issued on or after 1 March 2013 have to meet the above-mentioned requirements. As a consequence, issuers of structured products may have to restructure their products for any future issuance and distribution.
- Further, for all structured products that will be issued on or after 1 March 2013, prior to the subscription, a preliminary simplified prospectus has to be made available to investors free of charge. Indicative information in the preliminary simplified prospectus has to be declared as such, and the date of issue of the final simplified prospectus has to be indicated therein. And, as under the current legal regime, at the time of issuance, a final simplified prospectus has to be made available to investors free of charge. No (preliminary or final) simplified prospectus is required if the structured products (i) are listed on a Swiss exchange, provided that the Swiss exchange ensures the same transparency as a simplified prospectus pursuant to the CISA, or (ii) are not distributed in Switzerland but from Switzerland to non-qualified investors, provided that the applicable foreign regulations ensure the same transparency as a simplified prospectus pursuant to the CISA.

If the offering of, or advertisement for, the structured products will *not* be deemed a distribution to non-qualified investors within the meaning of the revised CISA the following actions need to be taken:

- the distribution documentation (incl. disclaimers and selling restrictions) and websites may need to be amended as per 1 June 2013 to reflect the new definition of qualified investors.
- Further, according to the strict wording of the CISO, the simplified prospectus must indicate that the structured products may be distributed to qualified investors only if they are not issued, guaranteed or secured in a similar manner by a Recognized Issuer. However, this seems to be an oversight of the legislator, as there was no intent to require that a simplified prospectus has to be made available to the investor, if the structured products are distributed to qualified investors only.

3. What will be considered as distribution?

Again, under the revised CISA, the offering of, or advertisement for, structured products in or from Switzerland is only subject to the CISA if it constitutes a (i) distribution (as defined below), (ii) to non-qualified investors (see 4. below).

All kind of offering of, or advertisement for, structured products will be considered as distribution under the revised CISA, unless such offering or advertisement is made:

- exclusively to a regulated financial institution such as a bank, securities dealer, fund management company, asset manager of collective investment schemes or central bank (each a “**Regulated Financial Institution**”) or a regulated insurance institution;
- on the basis of a strict reverse solicitation;
- by an asset manager to a Regulated Financial Institution on the basis of a written asset management agreement; or
- by an independent asset manager to its client on the basis of a written asset management agreement, provided that the independent asset manager is subject, (i) as financial intermediary, to the Swiss laws on anti-money laundering, and (ii) to the recognized conduct of business rules of an organisation in the financial sector (a “**Recognized Independent Asset Manager**”), and

the asset management agreement is in compliance with the recognized standards of the afore-mentioned organisation.

Further, the publication by regulated financial intermediaries of current prices, net asset values and tax data does not constitute a distribution of structured products, provided that such publication does not include any contact details.

4. Who will be treated as a qualified investor?

As of 1 June 2013, the following entities will be treated as qualified investors by operation of law:

- Regulated Financial Institutions and regulated insurance institutions;
- public entities and retirement benefits institutions with professional treasury operations; and
- companies with professional treasury operations.

Further, certain individual investors have the right to opt in or opt out, respectively:

- An investor who has concluded a written management agreement with a Recognized Independent Asset Manager or a Regulated Financial Institution will be deemed to be a qualified investor, provided that it does not declare that it wants to be treated as a non-qualified investor (opting out). The investor has to be informed of its status as qualified investor, the relevant risks involved, and its right to opt out before 1 June 2013.
- A high net worth individual (who does not fall within the above-mentioned category) may declare in writing that it wants to be treated as a qualified investor (opting in), provided that it (i) may demonstrate the knowledge necessary to understand the risks in connection with the investment based on individual education, professional experience or similar experience in the financial sector, and that it possesses bankable assets of at least CHF 500,000; or (ii) confirms in writing and demonstrates that it possesses financial assets of at least CHF 5 million. These are higher standards than those under the current legal regime, which require financial assets of

(only) CHF 2 million, but no proof of market knowledge. As of 1 March 2015, persons that are deemed high net worth individuals under the existing CISA which do not meet the above requirements may no longer enter into investments in structured products available to qualified investors only.

Any distribution to qualified investors has to be made by means customary for such specific investor base.

5. To what extent may structured products be distributed to non-qualified investors?

Structured products may only be distributed to non-qualified investors if the structured products are (i) issued, guaranteed or secured in a similar manner by a Recognized Issuer, and (ii) if a simplified prospectus will be made available to investors.

Structured products are deemed to be “secured in a similar manner”, provided that the Recognized Issuer, in a legally enforceable manner, undertakes:

- to fulfil the issuer’s obligation. In our view, such an undertaking, if governed by Swiss law, may in particular be provided in the form of a cumulative assumption of debt or a joint and several surety. However, the CISA does not prevent the parties to issue a similar instrument under foreign law; or
- to provide sufficient funding so that the claims of the investors can be satisfied.

Although not explicitly mentioned in the law, such a security requires an undertaking towards the investor (or a person acting for the investor) to adequately compensate the lack of a guarantee.

Further, structured products are also deemed to be secured in a similar manner, if collateral will be provided for the benefit of the investors. The collateral has to be located in Switzerland. The collateral secured instruments (COSI) engineered by the SIX Swiss Exchange may well be eligible for this category.

6. To what extent may structured products that are issued by a special purpose vehicle be distributed to non-qualified investors?

A more restrictive legal regime applies to structured products that are issued by a special purpose vehicle (“SPV”). Such structured products may only be distributed to non-qualified investors if

- the SPV is a company whose only purpose is the issuance of structured products and whose assets may only be used in the interest of the investors;

- the structured products are distributed by a Recognized Issuer; and

- the structured products are guaranteed or secured in a similar manner (see 5. above) by a Recognized Issuer.

In our view, the SPV may either be a single-issuance or a multi-issuance entity, with or without protected cells, provided that it does not qualify as collective investment scheme under the law of its domicile or under the CISA (see also the “FAQ” of the Swiss Financial Market Supervisory Authority FINMA regarding structured products in their version of 23 December 2010).

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