L-QIF (Limited Qualified Investor Fund)

The launch of the Limited Qualified Investor Fund (L-QIF) in Switzerland was a significant milestone in the investment landscape, as it offers a flexible, time- and cost-efficient investment vehicle for qualified investors. Its creation follows the amendments to the Collective Investment Schemes Act (CISA) and the Collective Investment Schemes Ordinance (CISO), which came into force on 1 March 2024. With the L-QIF, there is a new way to bundle and manage (alternative) assets.

Key features

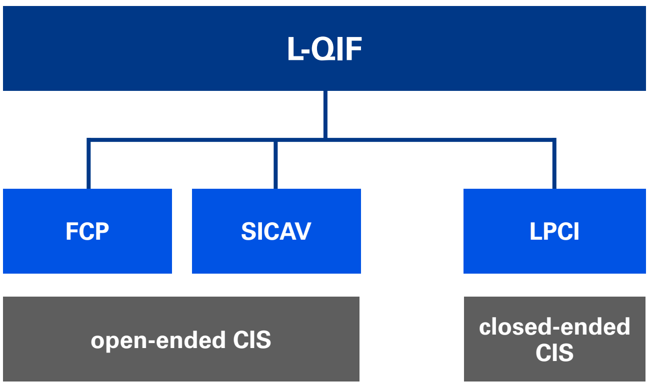
The L-QIF as a form of collective investment under Swiss law may be structured in the same way as traditional open-ended or closed-ended collective investment schemes (see "Legal forms of the L-QIF"). Unlike traditional investment vehicles, however, the L-QIF neither requires authorization from the Swiss Financial Market Supervisory Authority (FINMA) nor is it subject to its supervision. Not having to undergo the FINMA procedure, the L-QIF's time to market can be significantly faster and more cost-efficient, depending on how it is structured.

It also allows greater flexibility in terms of asset classes, investment techniques and restrictions as well as risk diversification. Thanks to this, investments can also be made in alternative assets and innovative strategies. Among others, these include cryptocurrencies, commodities, infrastructure projects and even art and wine. Access to the L-QIF is restricted to qualified investors only (see "Circle of investors" section).

Investor protection is achieved primarily by the fact that the L-QIF is subject to an annual financial audit and a so-called supplementary audit by a licensed and supervised auditor, in line with the existing Swiss fund structures. This should strengthen the competitiveness of Switzerland as a fund location. Market participants can use the L-QIF as an alternative to existing Swiss fund types, as well as an alternative to comparable European fund types, such as the Luxembourg Reserved Alternative Investment Fund ("RAIF").

Legal forms

According to Art. 118c CISA, an L-QIF can be structured either in the form of a contractual investment fund (FCP) or an investment company with variable capital (SICAV), both open-ended forms, or as a limited partnership for collective capital investments (LPCI), a closed-ended form.



It is not permitted for an L-QIF to be structured as an Investment company with fixed capital (SICAF). The reason for this is the abolition of bearer shares and the fact that a SICAF with registered shares, which is restricted exclusively to qualified investors, is not subject to the CISA.

Basic structure

Depending on the L-QIF's chosen legal form, different parties must be involved in the structure in accordance with the provisions of Art. 118g f. CISA. An L-QIF in the legal form of the contractual investment fund shall be managed by a fund management company. An L-QIF in the legal form of a SICAV is required to delegate the administration and investment decisions to one and the same fund management company (externally managed). An L-QIF in the legal form of a LPCI will have to assign its management to a manager of collective assets. One exception to this is if the general partners are banks, insurance companies within the meaning of the Insurance Supervision Act (ISA), securities firms, fund management companies or managers of collective assets.

Investment decisions may be sub-delegated to a manager of collective assets. Based on the licensing cascade, institutions with stricter regulatory requirements than a manager of collective assets may also be commissioned to do so. Under certain circumstances, delegation to a foreign manager of collective assets is also possible. However, it is not possible for a simple asset manager (portfolio manager / de minimis manager) to manage the assets.

Before taking up such activities, the aforementioned FINMA-regulated institutions must expand their organizational regulations to include L-QIF management as well as the targeted asset classes. This was detailed in a letter from FINMA to the institutions dated 23 February 2024. FINMA's letter also explicitly specified that the managing institutions involved must have the necessary organization (including comprehensive risk management), expertise and experience to manage an L-QIF (depending on its investment strategy and focus) for their entire business activity. L-QIFs in the legal form of a SICAV and contractual investment funds are required to include a FINMA-supervised custodian bank that fulfills the statutory duties under Art. 73 CISA, thus assuming an important supervisory function.

The duties of institutions manging L-QIFs, as mentioned above, are set out in Art. 118g and h CISA in connection with the implementing provisions under Art. 126h CISO. They include compliance with legal, contractual and supervisory provisions, which contributes to the L-QIF's integrity and legal certainty. Institutions managing an L-QIF must inform investors and the audit firm and, in the case of certain legal forms, the custodian bank, of any non-compliance with legal requirements or operational regulations and remedy the situation within a reasonable period of time. In addition, the institution must promptly notify FINMA, the custodian bank (depending on the legal form) and the audit firm should the conditions for an L-QIF pursuant to Art. 118a(1)(a–c) CISA no longer be met. Additionally, the institute may be subjected to supervisory measures. These measures ensure compliance with the responsibilities of the managing institutions and indirectly safeguard the integrity of the L-QIF concept when it comes to transparency and investor protection.

Circle of investors

Only qualified investors are eligible to invest in L-QIFs. As defined in Art. 10(3) CISA, qualified investors include professional clients pursuant to Art. 4 (3–5) or Art. 5 (1 and 4) of the Financial Services Act (FinSA). Also included in this category are high-net-worth retail clients who wish to be treated as professional clients (opting-out) and investors who have concluded a written investment advisory or asset management agreement, unless they declare that they do not wish to be treated as such (opting-in). Also, there are certain restrictions arising from tax aspects (see "Fiscal aspects" section). Financial service providers are also obliged to carry out suitability or appropriateness checks, as stipulated by the FinSA.

Among the qualified investors are also pension funds and occupational pension schemes with professional treasury services. Not only does this prevent the L-QIF from being placed at a disadvantage compared to foreign products such as the RAIF, it also recognizes the return potential for insured persons, which makes the L-QIF attractive for pension funds. Where necessary, the associated risks can be mitigated by corresponding investment regulations at ordinance level. A case in point would be the risk diversification regulations for collective investment schemes in accordance with the Ordinance on Occupational Retirement, Survivors' and Disability Pension Plans (BVV2).

Eligible investors also include supervised insurance institutions, whereby the conditions under which they may invest their free or tied assets in an L-QIF are defined by supervisory law (see specifically Art. 20 of the ISA, in conjunction with Art. 76 et seq. of the Insurance Supervision Ordinance (ISO)).

Lastly, L-QIFs can be set up as single-investor funds, but without being able to re-delegate investment decisions to institutions not supervised by FINMA (as otherwise both the asset manager and the investment product would be unsupervised).

FINMA procedure for changing the status of already authorized investments to an L-QIF

In principle, the switch from a supervised collective investment scheme to an L-QIF is possible in accordance with Art. 118b CISA in conjunction with Art. 126c and 126d CISO. However, it is subject to FINMA approval, with strict criteria to be met (Art. 118a(1) a–c CISA). Among other things, the fund contract must contain a provision that generally permits the change of status. In addition, a guarantee must be given that no costs will be incurred by the investment or investors. Additionally, contractual investment funds and SICAVs must obtain the custodian bank's consent and the explicit approval of the remaining investors, whereby SICAVs also need to obtain such consent from shareholders with at least two thirds of the shares. In the case of LPCIs, the consent of all investors is required. FINMA stipulates the prerequisites for the change of status and sets the date of release from supervision, while safeguarding investors' interests and voting rights. There is also an obligation to inform investors.

Special provisions for L-QIFs in the legal form of a contractual investment fund or SICAV

L-QIFs in the legal form of a contractual investment fund or a SICAV are subject to the special provisions pursuant to Art. 126i et seq. CISO with respect to the amendment of fund contracts, investment regulations or articles of association.

Further, within one year of its launch, an L-QIF must have net assets of at least CHF 5 million, with the fund management company being able to extend this period under certain conditions. Exceptions to the right to redeem units at any time may be made for L-QIFs with valuation constraints or limited marketability, i.e. units may only be redeemed on certain dates or under certain conditions, but at least every five years. The fund contract or investment regulations may also define a prorated reduction in redemption requests once a certain percentage or threshold value is reached for a specific time frame ("gating"). The aim of such regulations is to protect the interests of all investors and to tailor the redemption frequency to the type of investment.

Investment regulations for L-QIFs in the legal form of a contractual investment fund or SICAV

An essential aspect is the risk notice, which must appear as a warning clause on the first page of the fund contract or investment regulations as well as in marketing materials. Such a clause must outline the main risks of the potential investments in a concise manner. In addition, it is also required to explain particular risks and the potentially increased volatility of the L-QIF.

Any such restrictions must be explicitly stated in the fund contract or investment regulations along with a description of permitted investment techniques such as securities lending, the use of derivatives, borrowing, granting loans, transferring ownership by way of security or short selling. In the legal form of a contractual investment fund or SICAV, an L-QIF may take out loans of up to 50 percent of the net fund assets, pledge up to 100 percent of the net fund assets or assign them as collateral and enter into a total commitment of up to 600 percent of the net fund assets.

Compliance with these investment regulations must be ensured at all times. Any investment violations owing to market changes (passive breaches) must be immediately rectified in the interests of the investors. Any active breaches of the investment regulations require immediate correction. Should the loss or damage not be compensated, a corresponding notification must be sent to the audit firm immediately. The investors must be informed either as soon as possible in the official gazettes or directly in writing.

Supplementary provisions for L-QIFs in the legal form of contractual investment funds or SICAVs with real estate investments

L-QIF in the legal form of an FCP or a SICAV with real estate investments are subject to supplementary specific regulations pursuant to Art. 126t et seq. CISO. Such provisions include the definition of permissible real estate investments in the fund contract or investment regulations, the entry of lots and liens in the land register under the name of the fund management company or the SICAV together with the disclosure of the special risks associated with the acquisition of undeveloped properties. For construction projects or building renovations, the fund management company may encumber the L-QIF with a standard market building lease, to the extent that the costs do not exceed the estimated market value.

The provisions on real estate investments in co-ownership within the meaning of Art. 126u et seq. CISO permit the L-QIF to hold real estate in co-ownership, with the requirement that for minority shareholdings certain information such as the minimum shareholding and any restrictions on disposal must be disclosed. In addition, plots of land may not be encumbered for more than half of the average market value by pledging or assigning the liens as collateral.

For the purposes of risk diversification pursuant to Art. 126w CISO, the minimum number of plots of land and the relevant investment restrictions as a percentage of the L-QIF's assets must be disclosed. Under certain conditions, transactions with related parties are permitted, in which case an independent estimate of the conformity of the purchase or sale price with prevailing market conditions is required. The auditors must confirm compliance with the special fiduciary duty for real estate investments.

There are stringent requirements for valuation experts and the valuation of real estate investments, which are largely based on the previous (existing) real estate fund regulations within the meaning of the CISA: The mandated experts must be independent, have the necessary qualifications and provide financial guarantees or professional indemnity insurance. As a result, the L-QIF enjoys a high degree of professionalism and security in the management of this special asset class.

Investment rules for L-QIF in the legal form of an LPCI

Special investment regulations apply to L-QIFs in the legal form of LPCIs. Their articles of association must specify the investment restrictions and permissible investment techniques in detail. It must further contain rules on transactions with related parties. These are permitted only under strict conditions so as to avoid any conflicts of interest. Permissible are, in particular, construction, real estate and infrastructure projects by individuals with no direct or indirect connection to the general partner, the persons responsible for administration or management or the investors. In the case of transactions in which real estate or infrastructure assets are transferred from or to related parties, an independent valuation expert is required to confirm market conformity and the shareholders' meeting must give its approval.

The requirements for valuation experts and real estate investment valuations are governed by the regulations for L-QIFs with real estate investments in the legal form of FCPs and SICAVs (see section "Supplementary provisions for L-QIFs in the legal form of contractual investment funds or SICAVs with real estate investments").

The mandatory minimum term of five years is waived for L-QIFs in the legal form of an LPCI. This recognizes that, in certain circumstances, limited Partnership for collective capital investments with a shorter duration may also be advantageous and appropriate to meet specific investment objectives and requirements (e.g. for the venture capital/ private equity sector).

Fiscal aspects

For Swiss income and capital tax purposes, the L-QIF qualifies for tax transparency as it can be strutured in the basic forms of collective investment schemes such as SICAV, FCP or LPCI and will be treated accordingly. In other words, the L-QIF itself is not liable to tax; rather, the taxable income and net assets are attributed to the investors on a prorated basis, who then incur the corresponding taxes.

There are special rules for L-QIFs with direct real estate holdings, as current real estate income and capital gains from the sale of real estate are subject to profit tax or real estate gains tax at fund level. In this case, a reduced profit tax rate is applied for direct federal tax and, in most cases, also for cantonal and municipal taxes. Additionally, the net assets attributable to direct ownership are subject to capital tax. For Swiss investors, the income from direct real estate holdings recognized at L-QIF level and the net assets subject to capital tax are exempt from income and wealth tax. However, to prevent potential tax losses, L-QIFs with direct real estate holdings are not available to private individuals and their private investment structures with professional treasury operations (as qualified investors).

In terms of withholding tax, the L-QIF's distributions and reinvestments are subject to 35% withholding tax (dividends and interest, but not capital gains and capital repayments as well as real estate income from real estate investments with direct property ownership), as are other Swiss collective investment schemes. This may be a disincentive for foreign investors, as they can reclaim only part of the tax. And given that the L-QIF is not subject to unlimited tax liability in Switzerland, it cannot always benefit from double taxation agreements (DTAs) to reclaim foreign withholding tax. If a corresponding agreement exists, investors must seek a refund themselves. Be that as it may, the L-QIF can be made more attractive for foreign investors if it generates predominantly foreign income, which in turn makes the so-called affidavit procedure for direct relief from withholding tax applicable. As a collective investment scheme, the L-QIF is exempt from stamp duty, which makes transactions possible without such additional fees.

Despite the tax challenges outlined above, the L-QIF with its liberal investment rules and flexible risk diversification could prove to be an interesting alternative to foreign funds, which should further boost Switzerland as a financial hub.

Conclusion

The L-QIF is a notable innovation in the Swiss fund industry aimed at qualified investors. The new fund structure opens up opportunities to invest in alternative assets and is cost-efficient and quick to set up. Its tax-transparent structure offers additional advantages, particularly for real estate investments, which makes it even more appealing for this asset class.

How can KPMG help?

KPMG is one of the market leaders in advising, auditing and structuring collective investment schemes. Having gained extensive knowledge and experience in the fields of traditional and alternative investments as well as on regulatory obligations and reporting, we can assist you in developing a customized, approach to fit your needs. Our well-rehearsed team of experts can further support you in implementing your solution at organizational and product level in a targeted and efficient manner. We look forward to hearing from you!

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