Swiss pension funds as potential investors

Foreign collective investment schemes

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Swiss pension funds as potential investors

What should be observed in the distribution of foreign funds?

Currently, there are about 1,900 pension funds in Switzerland with an investment volume of nearly CHF 800 billion. Of these, just about 50 percent are held in collective investment schemes. Because of the ongoing low interest rates and even the partially negative interest rates, more and more pension funds are on the look-out for attractive investment options abroad. Indirect investments, such as units in international funds are especially appealing.

Figure: Overview of categories of institutional investors as per CISA

Distribution rules as per CISA

Under the Collective Investment Schemes Act (CISA) any kind of offering of or advertising for collective investment schemes (funds), which is not exclusively directed at (by the Swiss Financial Market Supervisory Authority, i.e. FINMA) prudentially supervised financial intermediaries, such as banks, securities dealers, fund management companies, asset managers of funds, central banks, as well as supervised insurance entities, is considered as distribution. Offering of or advertising for funds directed exclusively at banks, insurance companies, etc. is not considered to be distribution, and therefore are not regulated.[1]

The distribution of foreign funds to qualified investors in Switzerland assumes that such funds dispose of a representative and a paying agent in Switzerland. Moreover, any financial intermediary (distributor) wishing to distribute funds in Switzerland must either have been authorized by FINMA, or be adequately supervised in its country of incorporation, i.e. it must dispose of an authorization to distribute collective investment schemes. Furthermore, such financial intermediary must have concluded a distribution agreement in writing with the fund's representative in Switzerland.

Not all pension funds are qualified investors

Contrary to wide-spread opinion, Swiss pension funds are not considered to be "supervised financial intermediaries" as per CISA. Instead, pension funds are supervised in a decentralized manner by cantons or supervisory regions determined by the cantons. The offering of and advertising for funds directed at pension funds is, therefore, considered to be "distribution" and subject to the CISA distribution rules.

It should be noted that not all pension funds are considered to be "qualified investors" as per CISA. This only applies to pension funds that dispose of a professional treasury. Larger pension funds (more than CHF 1 billion) usually fulfill this criterion. It should, therefore, be checked carefully whether smaller (less than CHF 100m) and medium-sized (CHF 100m to 1bn) pension funds have such a professional treasury.

Prior to engaging in distribution activities (which is any type of offering of or advertising for funds), the above-mentioned distribution rules must be fulfilled if a pension fund disposes of a professional treasury which results in the CISA considering it to be a qualified investor. Therefore, prior to contacting a Swiss pension fund, it should be ensured that the distributor disposes of the necessary authorizations and the fund in question of a representative as well as a paying agent in Switzerland. If the pension fund does not dispose of a professional treasury, it is considered to be a non-qualified investor (i.e. a retail investor), which means that the foreign fund must be authorized in Switzerland before it may be distributed to the pension fund.

Adherence to investment regulations at fund level

Pension funds are subject to strict rules when it comes to the investment of the assets they manage. According to the Swiss Federal Act on Occupational Old Age, Survivors' and Invalidity Pension Provision (Occupational Pensions Act; OPA), pension funds must guarantee the security as well as an adequate risk diversification of their investments. The fund's investments must also provide sufficient returns and its projected liquidity requirement must be covered. Which types of investments are acceptable for pension funds is regulated in the Ordinance to the OPA (OPP 2).

Collective investment schemes are considered to be "acceptable investments", provided specific conditions are fulfilled. Adherence to the OPP 2 and the specific investment rules of the pension fund must be guaranteed at fund level. Specifically, this means that pension funds are only allowed to invest in a fund if the investments of the fund itself are permissible (look-through approach). Furthermore, an investment fund must fulfill certain conditions related to organizational form, allocation of competences, valuation of units, as well as the subscription and redemption of units. Should the fund provider go bankrupt, the assets invested in the fund must be ring-fenced from the assets of the fund provider. Furthermore, if a pension fund invests 5 percent or more of its total assets in a single fund, the target investments of the fund must be adequately diversified. As a rule, so-called alternative investments, such as hedge funds, are also permitted provided that they comply with the pension fund's own investment policy.

Leveraging is only permitted for alternative investments, for certain investments in real estate or regulated real estate funds as well as for investments in derivatives, provided that the total assets held by the pension fund are not being leveraged. As a general rule, investments containing a supplementary payment liability are not permitted.

Classification of investments according to OPP 2

Because of the applicability of the look-through approach, pension funds must consider the target investments of investment funds they wish to invest in. Because of this, certain monitoring costs will be incurred by the pension funds. Smaller and medium-sized pension funds therefore usually prefer to invest in "pure funds" (i.e. funds that invest only in shares or fixed-income investments). Fund providers will regularly be asked to guarantee the "purity" of their funds or to provide detailed information to the pension fund on the type and volume of the investments contained in the fund.

In practice, pension funds often require fund providers to provide a written confirmation of conformity with OPP 2 requirements of the respective fund. The evaluation of whether the investment policy as well as the actual investments indeed meet the OPP 2 requirements usually requires an effort that should not be underestimated.

Code of conduct for foreign asset managers?

According to OPP 2, pension funds must meet various requirements with regard to asset management. This concerns especially conduct rules with regard to the avoidance of conflicts of interest, transactions with related parties, transactions on own account and the acceptance of pecuniary benefits. Pension funds that have outsourced their asset management to third parties, must ensure that such third parties also adhere to these requirements and duties. In practice, pension funds, therefore, regularly require asset managers of funds to provide a confirmation that they are adhering to these conduct rules. This may cause uncertainties for foreign fund providers that are already subject to codes of conduct in the country of domicile and are not familiar with rules and regulations in Switzerland.

[1] Also see the KPMG fact sheet entitled "Distribution of foreign funds to institutional investors".

How can KPMG help?

KPMG disposes of a team of specialists who can support you in legal and economic aspects regarding the following topics:

- distribution of funds to Swiss pension funds;
- evaluation of entry into the Swiss market and selection of appropriate funds;
- development of a distribution system tailored to your needs;
- regulatory conditions for distribution (including contacting representatives and paying agents in Switzerland, drawing up of agreements, etc.);
- structuring of specific funds for pension funds;
- advice on the implementation of codes of conduct;
- support for the preparation of information material.

Beyond that, we can also help analyze your fund to determine its conformity to a particular pension fund's investment regulations, as well as the fund's OPP 2 conformity (classification of financial instruments in relation to OPP 2, use of derivatives and leveraged products, etc.).

Contacts:

KPMG AG
Badenerstrasse 172
PO Box
CH-8036 Zurich

Pascal Sprenger
Partner, Attorney-at-Law
Regulatory Competence Center
+41 58 249 42 23
psprenger@kpmg.com

Jürg Leu
Senior Manager, Attorney-at-Law
Regulatory Competence Center
+41 58 249 57 50
jleu@kpmg.com

Erich Meier
Director
Audit
+41 58 249 34 31
erichmeier@kpmg.com

Sandra Habermacher
Manager, Attorney-at-Law, LL. M.
Regulatory Competence Center
+41 58 249 53 15
shabermacher@kpmg.com