

Collective investment schemes regulations

I.G. Sergeeva

Saint-Petersburg state university of refrigeration and food engineering,
the department of economics and business

This publication contains some key facts on the regulation of collective investment schemes in the USA, Europe and Canada. Collective Investment Funds are created in different organization forms: corporation, trust, association. Investors in collective investments can reduce the risk of investing by investment diversification. The publication focuses on regulatory issues facing participants in the western investment management industry. This experience can be used in the collective investments practice in Russia.

Keywords: collective investment funds, mutual funds, closed-ended funds, open-ended investment companies, hedge funds, state regulations.

Collective Investment Funds (CIFs) are designed to enhance investment management by combining assets from different accounts into a single fund with a specific investment strategy. CIFs allow a large number of people to pool together their savings and to appoint an investment manager to act collectively on their behalf.

By using a CIF, an individual investor may obtain investment diversification that would otherwise be difficult to achieve. Investors in collective investments can reduce the risk of investing by spreading the risk of their investment, as the fund manager will be able to purchase a far greater number of investments than the individual investor.

USA

The USA as a pioneer in collective investments sphere have wide specter of these institutes [7]. Under action of Investment Company Act, they can found formations, which are created as:

- a corporation;
- a joint-stock company;
- a trust;
- an association;
- an other organization forms.
- Companies which are referred to the collective investments are engaged in managing of the following:
 - natural investors assets;
 - corporative investors assets;
 - pensionary savings;
 - mortgage credit pools;

- other material pools, made for special purposes.

The first CIF was organized under state law in 1927. In 1936, Congress amended the Internal Revenue Code (IRC) to provide tax-exempt status to certain CIFs maintained by a bank [1]. In 1937, the Federal Reserve promulgated special regulation that authorized banks to establish common trust funds. In 1938, the National Conference of Commissioners of Uniform State Laws approved the Uniform Common Trust Fund Act and recommended that each state adopt it. Despite the existence of this uniform act, many states crafted their own CIF statutory language resulting in a broad range of CIF statutes.

In 1962, Congress transferred supervisory responsibility for the fiduciary activities of national banks from the Federal Reserve to the Office of the Comptroller of the Currency (OCC). The OCC's adoption of a rule that established standards for CIFs operated by national banks served as a model for subsequently enacted state statutes. The OCC has approved a variety of national bank proposals for the establishment of CIFs to collectively invest assets such as IRA (Individual Retirement Account) funds and other tax-exempt accounts for which the bank serves as trustee. However, banks offering these funds must be familiar with guidance issued by both the OCC and the Securities and Exchange Commission (SEC) in this area.

Among the organizational structures regulated by Investment Company Act (of 1940) are the funds organized on a base of trusting property (trust), open-end or mutual funds and closed-end funds [2]. Mutual funds are investment companies that must register with the U.S. Securities and Exchange Commission (SEC) and, as such, are subject to rigorous regulatory oversight. Virtually every aspect of a mutual fund's structure and operation is subject to strict regulation under four federal laws: the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act [2, 3, 4]. The SEC is charged with overseeing the mutual fund industry's compliance with these regulations. The Internal Revenue Code sets additional requirements regarding a fund's portfolio diversification and its distribution of earnings, and the National Association of Securities Dealers, Inc. (NASD) oversees most mutual fund advertisements and other sales materials. In addition, mutual funds must have directors who are responsible for extensive oversight of the fund's policies and procedures. For virtually all funds, at least a majority of their directors must be independent from the fund's management.

The Investment Company Act is the cornerstone of mutual fund regulation. It regulates the structure and operation of mutual funds and requires funds to safeguard their portfolio securities, forward price their securities, and keep detailed books and records. In addition, the 1933 Act requires all prospective fund investors to receive a prospectus containing specific information about the fund's management, holdings, fees and expenses, and performance [3].

A CIF is a bank-administered trust that holds commingled assets that meet specific criteria established by regulations. The bank acts as a fiduciary for the CIF and holds legal title to the fund's assets. Participants in a CIF are the beneficial owners of the fund's assets. While each participant owns an undivided interest in the

aggregate assets of a CIF, a participant does not directly own any specific asset held by a CIF.

US regulation authorizes two general types of CIFs. The first is maintained exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian. This type of fund is generally referred to as an A1 fund. The industry generally uses the term “common trust fund” when referring to A1 funds.

The second type of CIF is a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts that are exempt from federal income tax. This type of fund is generally referred to as an A2 fund. The industry generally uses the term “collective investment fund” when referring to A2 funds.

A bank is not required to be a fiduciary with discretion in order to commingle assets in an A2 fund. A bank may serve as directed agent or nondiscretionary custodian for an employee benefit (EB) plan account and may invest plan assets into its A2 fund, so long as the fund itself qualifies for an exemption from federal taxation. The bank need not act as the trustee for the underlying tax-exempt trust.

A bank is authorized to combine assets eligible for participation in an A2 fund, so long as the bank serves as trustee for the underlying EB plans. However, a bank should carefully consider both the tax and securities law implications of combining assets in this way. It would be unusual for a bank to combine assets subject to different tax treatments or with different investment objectives into a single fund. A bank may establish a network of funds or a “fund of funds” in which assets of one or more A2 funds are invested in another A2 fund. Banks should ensure that admissions into their CIFs are closely scrutinized to ensure that ineligible accounts are not admitted into a CIF. The admission of even one ineligible account into a CIF could potentially raise tax and securities implications for the entire fund.

A subset of both A1 and A2 funds are short-term investment funds, or STIFs. STIFs offer liquidity, an optimum return, and a stable value. However, STIFs are not required to maintain a stable net asset value or price per share as their primary objective.

In addition to A1 and A2 Funds, US regulation authorizes other collective investments for national banks to the extent not prohibited by applicable law.

The OCC recognizes other specific arrangements by which a national bank may collectively invest assets that it holds as a fiduciary, so long as applicable law does not prohibit those arrangements. Bank counsel should ensure that any such collective investment meets the required exemptions from applicable federal securities laws.

A national bank may collectively invest assets that it holds as fiduciary in:

- A single real estate loan, a direct obligation of the United States, an obligation fully guaranteed by the United States, or a single fixed amount security, obligation, or other property, either real, personal, or mixed, of a single issuer;
- A variable amount note of a borrower of prime credit, if the bank uses the note solely for investment of funds held in its fiduciary accounts.

A national bank often holds relatively small dollar accounts in its capacity as trustee, executor, administrator, guardian, or custodian. Because cash balances in these accounts are often too small to be advantageously invested separately, the bank may establish a fund expressly for these balances' collective investment. The maximum amount of assets that may be held in such a "mini-fund" is \$1,000,000, and the maximum number of participating accounts in any one mini-fund is 100.

When a trust is created by a corporation (including its affiliates and subsidiaries), or by several individual but closely related settlors, a national bank is authorized to collectively invest the trust assets that it holds as a fiduciary in any investment specifically authorized by the instrument creating the fiduciary account or by court order.

A bank may serve as an administrator, investment adviser, or investment manager of a pooled income fund. These are funds maintained by a third-party organization, such as a church or an educational institution. These pooled funds customarily pool charitable gifts from individual donors. Pooled funds are not CIFs and may not be operated by a bank as a CIF. Pooled funds are not governed by OCC Regulation, but instead must fall within specific exemptions provided under the federal tax and securities laws.

A national bank is authorized to administer a CIF and is not required to register the fund under the federal securities laws if the fund qualifies for specific exemptions to the Securities Act of 1933 (the '33 Act) and the exclusions provided in the Investment Company Act of 1940 (the '40 Act). A CIF is fundamentally different from a registered investment company because only eligible assets may be admitted in a CIF. By contrast, funds from any source may be invested in an investment company.

The Investment Company Act of 1940 (the '40 Act) regulates the formation and operation of investment companies (e.g., mutual funds) [2]. The '40 Act contains two specific exclusions from the definition of "investment company" that allow banks to operate CIFs without registering them with the SEC. The first exclusion generally covers all A1 funds. It provides an exclusion from investment company registration for any common trust fund or similar fund maintained by a bank that is exclusively for the collective investment and reinvestment of moneys contributed by the bank in its capacity as a trustee, executor, administrator, or guardian, if:

- (a) A bank sponsors the CIF solely as an aid to the administration of trusts, estates, or other accounts created and maintained for a fiduciary purpose;
- (b) Interests in the CIF are not advertised or offered for sale to the general public except in connection with the ordinary advertising of the bank's fiduciary services; and
- (c) Fees and expenses charged by the CIF do not violate fiduciary principles established under applicable federal or state law.

In 1999, the Gramm-Leach-Bliley Act (GLBA) imposed additional restrictions on a bank's ability to advertise a CIF and to make it available to the general public, and further limited the fees these funds may charge [5]. These statutory restrictions

generally codified previous SEC interpretations that limited a bank's ability to market A1 funds.

The second exclusion covers A2 funds. It provides an exclusion from the registration, disclosure, and recordkeeping requirements of the '40 Act for most A2 funds. Among other things, it exempts any "collective trust fund maintained by a bank" consisting solely of assets of:

- (a) Any employee's stock bonus, pension, or profit-sharing trusts which meet the requirements for qualification under the Internal Revenue Code of 1986 (IRC);
- (b) Governmental plans.

These two exclusions do not expressly cover CIFs that contain Individual Retirement Account (IRA) assets. Individual Retirement Accounts (IRAs) are authorized as tax-exempt accounts under the IRC. OCC regulations authorize a bank to invest IRA assets in a CIF. Under the SEC's interpretation of the securities laws, however, a bank that operates a CIF and invests IRA assets in that fund may be considered to be operating the CIF in violation of the '40 Act. The SEC, however, has expressly authorized banks to operate CIFs that accept IRAs if those funds are registered with the SEC as registered investment companies under the '40 Act and as securities under the '33 Act.

National banks should also consult with securities counsel if they intend to combine different assets (e.g., personal trust and pension assets) in a single CIF. A bank should obtain specific securities law advice in this area. Banks should also consider potential securities law restricting the investment of fiduciary assets held by one bank into an A1 fund of an unaffiliated institution. While SEC guidance authorizes affiliated banks under a single holding company to combine their A1 and A2 funds, the SEC has not authorized a bank's consolidation of assets from unaffiliated banks into a single A1 fund. This restriction may apply even where applicable law (state trust law or the governing instrument) expressly authorizes a trustee to invest the assets in an unaffiliated bank's CIF.

In addition to complying with securities laws, a bank must also comply with the Employee Retirement Income Security Act of 1974 (ERISA) if one or more employee benefit plans regulated by ERISA participate in the CIF [6]. In general, ERISA prohibits an ERISA fiduciary (such as a bank trustee) from making fiduciary decisions from which it might benefit or from engaging in certain transactions with parties in interest (e.g., certain entities that are related to the plan or provide services to the plan or their affiliates).

ERISA allows otherwise prohibited transactions between participating accounts and a CIF if three conditions are met:

- The transaction is a sale or purchase of an interest in the fund;
- The bank does not receive more than reasonable compensation;
- The instrument under which the plan is maintained, or a fiduciary (other than the bank or bank affiliate) that has authority to control and manage assets of the plan, expressly permits the transaction.

European system

Development of collective investments in Europe has a comparatively short history. Nevertheless recently we may see a significant growth in this sector. Different organizational forms for collective investment programs are available. Only Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to Undertakings for Collective Investment in Transferable Securities (UCITS) supposes to use different models in those purposes:

- contract model (for instance German Offene und Geschlossene Fonds);
- trust model (for instance English Unit Trust);
- corporative model (for instance French Societe d'Investissement a Capital Variable (SICAV).

Trusts and contract funds are based on traditional standards:

- making of property pool by selling shares in fund to investors, certified by a security of an appropriate form;
- contract model, as a rule, considers making contract between an investor and an investment manager who gives a security to the investor certifying appropriate relations; trust model considers a trustee who mediates relations with an Investment Advisor;
- the investment company managing the fund deposits in securities which have an exchange quotation.

UK

There are three broad levels of regulation of collective investment schemes in the United Kingdom. These can be summarised as European, HM Government and the FSA (Financial Services Authority). They should be viewed as a hierarchy of rules that, at each level, deals with more specific aspects of collective investment scheme regulation.

European collective investment scheme regulation was introduced in 1985 by the UCITS Directive and this has been updated by amendments to the Directive which came into force in February 2004.

The main Government legislation is the Act and the OEIC Regulations.

According to the Financial Services Authority (FSA) rules, collective investment schemes are classified as either regulated, or unregulated, collective investment schemes [8].

Regulated Collective Investment Schemes

Authorized Investment funds are open-ended collective investment schemes registered and regulated in the UK by the FSA. This category includes unit trusts and OEICs.

FSA Recognized are funds registered in certain jurisdictions outside the UK, authorized and supervised by the local regulator but are recognized by the FSA for the purposes of marketing to UK investors. In essence, the FSA is recognizing the

competence of the local regulator and is passporting the funds for promotion in the UK.

Unregulated Collective Investment Schemes (UCIS)

Regulated funds are those funds that are registered in certain jurisdictions other than the UK and are regulated only in the country of registration. They are not, therefore, approved by the FSA in the way that Recognized funds are. Funds in this category, which includes property and hedge funds, are available to UK investors but cannot be marketed to the UK public.

Other funds include any funds which may not be regulated by any authority, whether recognized by the FSA or not. This category includes hedge funds.

In the UK, collective investment schemes are classified into three categories:

- Investment Trust which is a closed-ended fund actually quoted on the stock market;
- Unit Trust which is a contractual and open-ended model;
- Open-Ended Investment Company (OEIC) which is a corporate model [9].

So the traditional model of mutual funds in the UK has been the Unit Trust. And up until 1997, that was the only open-ended structure in the UK. In 1997 it was introduced a second parallel model which is actually a corporate model of the open-ended investment company. The basic reason was that asset management is an international business and particularly asset management in Europe is a Europe-wide business. The Unit Trust as a legal structure was very difficult and it was impossible to sell it in other European jurisdictions because of differently legal traditions. So the open-ended investment company, which is incorporated under company law effectively was introduced and it was a structure, which was recognizable in Continental Europe.

Unit Trusts

A unit trust scheme is a collective investment scheme under which the property is held on trust for the participants by the trustee. A unit trust scheme is legally a trust, having a trustee and beneficiaries. The unit trust constitutes a pool of investments made up of the contributions of investors. The pool of investments is divided into equal portions called units, and unit trust investors hold a number of units depending on how much they have contributed. The investors in the unit trust are beneficially entitled to an undivided share of the investments subject to the trust and are referred to as unit holders. The price of units is determined by the managers of the trust (usually on a daily basis) at the current market value of the investments held in the fund.

The unit trust is the traditional structure in the UK. The basic idea of the unit trust is that it is entered into via a contract between the investor and the manager, and that contract is made under Trust Law. The assets of the investor are held in a separate trust by a trustee who is appointed by the manager.

So there are three parties to a unit trust: the manager, the trustee who must be unconnected to the manager, and the unit holders who are the trust beneficiaries. The independent trustee holds the assets and part of the trustee's responsibility then is to

issue and redeem units in the fund and it is those units which the investor owns. In effect, they are like a share in a corporate structure, but there is a difference of unique structure of the Unit Trust units which is an entity which is issued by the trustee.

The trustee is responsible for custody the assets and he is also responsible for oversight of the manager. This potentially creates a conflict. The conflict in this structure is that on the one hand the manager appoints the trustee and on the other hand, the trustee has a responsibility to oversee the manager.

So there is clearly a potential conflict and it is one that is resolved by regulation in the UK because in this structure there are three regulated entities. The manager is regulated, the trustee is regulated, and the fund is authorized. So there are three separate authorizations by the regulator in this structure.

There are following relationships between the trustee, depository and the fund manager. One of the trustee's responsibilities is custody, which he will frequently delegate to obviously one of the global custodians. He has a relationship with the manager and both those are regulated by the FSA. So there is a relationship between two regulated entities going on there. So ultimately, all of that relationship is overseen by the regulator.

Many of the regulatory duties of the fund manager, he may well delegate, particularly pricing and fund accounting will be delegated to a fund accountant and that then in turn will be overseen by the auditor of the fund. The fund manager takes the day-to-day investment. So he is managing the investments. The fund manager does actually deal as a principal in the units. So he holds units on his own balance sheet which are created by the trustee, the manager holds the units in a pool, and issues them, and takes them back as investors buy or redeem units. The manager is responsible for the daily pricing of the assets, and is responsible for maintaining the financial records.

The depository safeguards the assets of the scheme. The depository has to be independent of the manager. And it has got to look at all the aspects of the fund manager's activities with no responsibility performance. Anything the manager does in the operation of the scheme, the depository has got to oversee and check that the manager is carrying out procedures and risk controls in the proper fashion and complying with all the rules and regulations.

Open-ended Investment Company (OEIC)

An open-ended investment company (OEIC) is a collective investment scheme that is structured as a company. OEICs are usually authorized by the Financial Services Authority (FSA) and for tax purposes they are treated the same as a unit trust.

OEICs are a type of collective investment, combining elements of both unit trusts and investment trusts. They pool investors' money in order to purchase a diversified portfolio of stocks and shares within a stated set of investment objectives. Fund managers are responsible for all investment decisions relating to the underlying portfolio of securities.

An OEIC works much like a unit trust, except that an OEIC is legally constituted as a limited company, so that investors buy shares, rather than units. A depository oversees the operation to ensure investor protection in much the same way

as a trustee would act for a unit trust. The major difference between OEICs and investment trusts is that the number of shares in issuance varies according to demand, hence the term open-ended. So the share price always reflects the underlying asset value and is not affected by market sentiment towards the OEIC itself. Unlike investment trusts, OEICs' shares will not trade at a premium or a discount.

Most OEICs operate as umbrella funds, which mean that, once the OEIC is authorized, it can set up a series of sub-funds. Each sub-fund can have a different investment aim. For example, a sub-fund may specialize in the shares of smaller companies or in a particular country, such as the US or Japan. It is also possible for each sub-fund to have different charges and different minimum and maximum investment requirements. As a result, OEICs are more flexible than unit trusts: the umbrella-fund structure enables investors to switch more easily and cheaply between funds run by the same investment-management company.

In addition, there exists a depository who has the same responsibilities for custody and oversight that the trustee has in the Unit Trust. The one difference is that the trustee does not own the assets. The company owns the assets in case of the OEIC.

The primary fiduciary safeguards are in the FSA regulations. The schemes themselves, the funds have to be authorized before they can be sold, and there is a whole set of FSA regulations about systems controls, risk controls and so on. All those are the same for Unit Trusts and for OEICs.

OEICs have been run successfully for several years outside the UK, but it only became possible to operate an OEIC here after 1997. There has been a further modification to the scheme in 2004. A new regime was introduced with a name of COLL (the New Collective Investment Schemes sourcebook), where COLL means it is short for Collective Investment Scheme. The previous regime was called the CIS regime, an acronym meaning Collective Investment Scheme. The new regime, which is still the regime governing Collective Investment Schemes, in order to distinguish itself is now like known as COLL. The principal changes remove the remaining regulatory differences between Unit Trust and OEICs.

So it is now possible for Unit Trusts and OEICs to be either single priced or dual priced. It is possible for Unit Trust to have sub-share classes in the way that OEICs do so that the distinction between Unit Trust and OEICs in practical terms is pretty much vanished.

Hedge Funds

The special category of Unregulated Collective Investment Schemes (UCIS) is hedge funds. Although hedge funds are collective investment vehicles, they differ significantly from traditional funds in that their goal is to produce profits in a variety of market conditions, not just when stock markets are rising. They are usually unregulated and are therefore unrestricted in the range of investment styles and instruments they can use. This freedom from regulation permits hedge funds to engage in leverage and other sophisticated investment techniques to a much greater extent than traditional trusts can.

Hedge fund managers typically pursue a specific, focused investment strategy and do not relate their performance to an equity benchmark. Contrary to traditional

asset managers, hedge fund managers do not focus on outperforming specific markets; instead, they seek to generate positive absolute returns, regardless of market conditions. In order to do so, most of them take relative positions, with the aim of exploiting existing or expected inefficiencies in the markets and imbalances in the prices of securities. Such strategies can be relatively independent of, and insulated from, broad movements in financial markets. This investment approach is particularly appealing when markets experience downturns. However, not all hedge funds pursue low-risk strategies. Some take a considerable amount of risk, either because of the instruments they use or because of the amount of leverage they employ. It is also possible for hedge funds to have more than one strategy at a time.

Leverage (otherwise known as gearing) is one of the tools available to hedge funds. It enables managers to increase the size of their positions by borrowing money to invest. The typical level of leveraging is between one and five times. A second tool is short-selling (or «shorting»). This means selling a stock that the fund has borrowed (in return for a one-off charge) in the expectation that its price will fall. If the price falls, the broker buys the stock at a lower price than it was sold at and returns it to the original lender, thus making a profit. Derivatives, such as options, can be used to achieve the same aims as shorting.

Canada

In Canada the mutual fund industry is governed by provincial and territorial legislation regulating the underwriting, distribution and sale of securities. A primary objective of this legislation is full disclosure for all securities, including mutual funds. Disclosure requirements are usually met through the provision of a prospectus issued by the company and accepted for filing by the regulatory body. Securities legislation also requires the continual disclosure of information by companies, such as the regular issuing of financial statements, and most provinces and territories require that this information be sent directly to individuals purchasing units in mutual funds and to other shareholders. Legislation also requires that securities dealers and advisors register with the relevant provincial or territorial regulatory authority.

While each province and territory has its own legislation, regulators meet on a regular basis in an effort to coordinate and harmonize regulation of the securities industry and markets. For example, there has been an increase in the number of national policies issued by the Canadian Securities Administrators in an attempt to create a consistent set of regulations across Canada. Nevertheless, mutual fund companies must file regulatory documents with the relevant provincial and territorial securities authorities.

There is also extensive self-regulation by the Investment Dealers Association of Canada (IDA), the Mutual Fund Dealers Association of Canada (MFDA) and the stock exchanges. The IDA regulates its own members who are involved in the sale of securities including mutual funds, while the MFDA regulates the distribution side of the mutual fund industry. Self-regulatory organizations have the power to admit members and perform compliance reviews. For example, investment advisors involved in the sale of mutual funds to the public must register with the applicable stock exchange or the IDA, and must complete industry-sponsored training programs

before being permitted to sell mutual funds and other securities. The self-regulatory organizations also have the power to establish and enforce industry regulations to protect consumers and to ensure companies conduct their business in a fair and ethical manner.

Switzerland

The Swiss system of supervision allows for the delegation of certain duties to self-regulating organizations in various fields. In particular, licensed stock exchanges assume far-reaching admission and monitoring functions. The Swiss Bankers' Association and the Swiss Funds Association (SFA) issue self-regulatory guidelines to its members in certain areas of banking collective investment schemes respectively, which the Swiss Federal Banking Commission (SFBC) recognizes as binding minimum standards. They have the force of compulsory rules of conduct and compliance with them must be verified by the authorized auditor. This is true in particular as regards the duty of due diligence in identifying the contracting party and beneficial owner, the rules of conduct for securities trading and the guidelines governing portfolio management and the examination, valuation and treatment of mortgage-backed loans.

The new Federal Act on Collective Investment Schemes (Collective Investment Schemes Act; CISA) and the Collective Investment Schemes Ordinance (CISO) have been in force since 1st January 2007. These two pieces of legislation are supplemented by the SFBC Ordinance on Collective Investment Schemes (CISO-SFBC), which came into force on 15 February 2007. The latter supersede the Federal Act on Investment Funds (IFA) and its associated Investment Funds Ordinance (IFO), which were repealed on 1st January 2007, while the Investment Funds Ordinance of the SFBC (IFO-SFBC) was repealed on 15th February 2007. The legislation is supplemented by SFBC Circulars, while self-regulatory rules of industry organizations may be recognized by the SFBC as a minimum standard.

The law aims at enhancing the competitiveness of the Swiss financial centre for the production and distribution of domestic and international funds. The government also planned to make Swiss regulation become eurocompatible. It has also extended the scope of the legislation to collective investment schemes in the form of corporations (investment company with variable capital [SICAV], investment company with fixed capital [SICAF] and limited partnership for collective investments), and achieved a general liberalization in this area. Additionally, the protection accorded to investors now reflects their differing needs and status as it distinguishes between "ordinary" and "qualified" investors. The Act is also designed to reinforce their rights and further enhance transparency.

Investment companies in the form of public limited companies which are listed on a Swiss stock exchange or which shareholders are only qualified investors, in-house funds set up on a contractual basis by a bank or a securities dealer and structured products are exempted under the CISA.

In addition, the law introduced the following novelties:

The asset manager can apply for prudential supervision by the Swiss Federal Banking Commission which enables it to manage foreign-domiciled collective investment schemes.

The Swiss Federal Banking Commission is entitled to approve internet platforms as official publication organs.

The supervisory can meet agreements with foreign supervisory in view of simplifying the market access for foreign collective investment schemes.

The SFBC grants the authorizations and approvals required under the Act and supervises compliance with the legal, contractual, statutory and regulatory provisions. The CISA and its associated ordinances set forth the conditions for granting an authorization. In particular, they govern the investment principles of the various forms of collective investment and specify the minimum content of the documents that require approval.

The CISA distinguishes between the concepts of authorization and approval. Institutions that are subject to supervision require an authorization, while the documents of collective investment schemes require an approval.

Any individual or entity that manages or acts as a custodian for collective investments, requires the authorization of the Swiss Federal Banking Commission. This includes:

- fund management companies;
- SICAVs;
- limited partnerships for collective investments;
- SICAFs;
- custodian banks;
- asset managers of Swiss collective investment schemes;
- distributors;
- representatives of foreign collective investment schemes.

Asset managers of foreign collective investment schemes may apply for an authorization from the supervisory authority. The criterion for an authorization for distributors and representatives of foreign collective investment schemes is still triggered by public advertising. Authorizations are granted to all the institutions above if both the general and the specific conditions are fulfilled.

The following documents for collective investment schemes require the approval of the SFBC:

- the collective investment contract of investment funds;
- the Articles of Incorporation and investment regulations of SICAVs;
- the partnership agreement of limited partnerships for collective investments;
- the Articles of Incorporation and investment regulations of SICAFs;
- the corresponding documents of foreign collective investment schemes.

Approval is granted when the product complies with the applicable legal requirements. SICAVs, SICAFs and limited partnerships for collective investments require both an authorization as an institution and an approval for their product or products.

The dual supervisory system requires fund management companies (both for themselves and for the funds they manage), SICAVs, SICAFs, limited partnerships for collective investments, asset managers of collective investment schemes and

representatives of foreign collective investment schemes to designate an auditor recognized by the Banking Commission. Distributors are not obliged to comply with this requirement, while custodian banks already have a recognized auditor. The auditor examines whether the authorization holder complies with the legal, statutory and regulatory requirements. Its findings are set out in a report which is delivered to both the authorization holder and the supervisory authority.

References

Laws

1. Internal Revenue Code
2. Investment Company Act of 1940 ('40 Act)
3. Securities Act of 1933 ('33 Act)
4. Securities Exchange Act of 1934 ('34 Act)
5. The Gramm-Leach-Bliley Act of 1999
6. Employee Retirement Income Security Act of 1974 (ERISA)

Other Reference Sources

7. Collective Investment Funds. Comptroller's Handbook, October 2005
8. Collective Investment Scheme Information Guide. FSA, 2006
9. The Regulation and Structure of Collective Investment Vehicles in the United Kingdom. AEI Conference, May 2006