SWITZERLAND

As a reputable hedge fund jurisdiction at the heart of the European finance community, Swiss capital Geneva, along with the industry at large, is currently dealing with the effects of investor redemptions and the Madoff scandal. But, with a long-standing pedigree and regulatory innovations to rely on, those involved in the Swiss hedge fund industry tell *HFMWeek* that they are confident about future growth in the region

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PHILIPPE BENS is managing director of CACEIS Fastnet (Suisse) SA, a branch of the CACEIS Group specialising in fund administration. He started his career working with Banque du Luxembourg. In December 1994, he headed custody operations for Crédit Agricole Indosuez Luxembourg, moving to Fastnet Luxembourg as head of strategic projects in 2000.

GLEN MILLAR is a qualified FCMA/AMCT with 10 years' experience as a CFO across Europe/MEA and 10 years as a consultant on business intelligence, process and systems design. He heads the Swiss office for Kinetic Partners.

HFMWeek: What are the advantages of setting up a fund in Switzerland?

Dominique Lecocq (DL): There are many arguments for operating from Switzerland including the regulatory environment, the tax treatment, marketing and management know-how.

A licence from the Swiss Financial Market Supervisory Authority (FINMA) is the only requirement for the management of Swiss-based investment funds. Managers of offshore funds do not have to seek a licence in Switzerland. The only regulatory burden is to register with a self-regulated body for anti-money laundering purposes. This is a very straightforward and easy process.

The tax environment is also very favorable. The Geneva tax authorities make efforts to encourage funds and fund managers to come to Geneva. Depending on the structure, the operations and the substance of the manager/advisor in Switzerland, a cost-plus (5%-10%) tax advantage ruling may be granted. The tax administration is currently confirming a new practice to grant an attractive tax treatment of performance fees.

Finally, the Geneva finance industry and private banking sector have been active in the alternative asset management industry for a very long time. There are a lot of potential investors including banks, external assets managers, pension funds, or other institutional investors and business angles.

Glen Millar (GM): The advantages of setting up a fund management operation here are similar to those for moving any business here or relocating here as an individual: quality of life, good communications, healthcare, public transport system, schooling, and an encouraging tax and regulatory regime. From the fund manager's perspective, tax rates are generally lower than those found elsewhere in Western Europe and a number of arrangements are possible, from seeking a lump sum agreement for personal taxation to seeking a ruling on establishing a new operation here. The authorities go out of their way to make it easier for companies thinking of setting up part or all of their business here.

Philippe Bens (PB): For fund management companies, Switzerland is a jurisdiction that provides significant potential for innovation through the January 2007 Swiss Federal Act on Collective Investment Schemes (CISA). The law, which was aimed at promoting Switzerland's highly regulated fund market, gives fund management companies regulatory status, allowing them to manage Swiss funds that are approved by FINMA, the country's financial market supervisory authority. The combination of this flexible regulatory landscape with a favourable tax regime and a well-educated, multi-lingual work force makes Switzerland one of Europe's most attractive fund centres.

HFMWeek: With such an abundance of investors based in the region, has the jurisdiction been affected badly by a recent flight towards redemptions?

GM: Historically, Swiss-based family offices and Swiss-based funds of funds were early investors in hedge funds. Many family offices redeemed out of hedge funds last year, either because they saw cash as a safer haven or because they were forced to redeem holdings for other reasons. The Madoff scandal exacerbated the problem for fund of hedge funds (FoHF) managers.

Geneva in particular was very badly hit by the Madoff scandal. Assets under management may have dropped by around half for many FoHF managers, as investors have sought refuge in cash. However, it is likely that alternative investments will continue to be an attractive element of a diversified portfolio, given their return relative to the rest of the financial markets, and some of this cash is already finding its way back to the alternatives industry.

PB: As was the case for most of the world's leading fund centres, Switzerland experienced a spike in the number of redemptions shortly following the start of the financial crisis. However, today, investors are gradually regaining confidence and capital outflows have significantly reduced. Furthermore, Switzerland's economy is also relatively diversified, encompassing agriculture, luxury goods manufacturing and tourism, so the country is less reliant on its financial sector than certain other jurisdictions.

DL: There have been a number of redemptions and generally the net asset values of some funds have decreased. Apart from some exceptions, my clients have generally maintained an adequate level of assets in their funds and some of them have generated an outstanding performance since January 2009. This is a question of trust between the manager and the investors.

HFMWeek: Despite recent turmoil, what sorts

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of new business have you seeing coming in to the region?

GM: We continue to see single hedge funds looking to establish or expand their operations in Switzerland. Switzerland is already strongly represented in the FoHF area, with over 30% of the global market, but it has been under-represented in the single hedge fund area since leading the market in the 1990s. Wealthy individuals continue to seek refuge here, and outside of financial services both trading and the biotech industry have held up well so far.

PB: We have experienced an increase in the number of alternative managers based in Switzerland looking to set up new products locally rather than abroad. Pre-crisis, there was a trend among Swiss managers to launch new products through foreign jurisdictions, but the time–to-market concerns of launching products such as fund of hedge funds through Luxembourg or Dublin, possibly in connection with an improved understanding of how to exploit the provisions of the flexible CISA law, has seen managers seek to keep new product development closer to home.

DL: Some managers are focusing on different strategies including trade finance and lending funds. This was in response to the lack of liquidity in the market. Among the existing strategies, a more controlled level of leverage is used.

HFMWeek: What work is being done by authorities in the region to attract hedge funds?

PB: In September 2007, the Swiss Bankers Association, the Swiss Insurance Association, the Swiss Funds Association and Swiss Financial Market Services published the 'Swiss Financial Centre Master Plan'; drawn up as part of a joint project. The goal of the master plan was to strengthen and develop the international competitiveness of the Swiss financial sector. The plan advocated measures, such as transparency enhancing regulation and an overhaul of the fiscal infrastructure, many of which have already been implemented to attract alternative funds. In addition, FINMA also repealled the 'Swiss finish', a set of regulations on top of internationally required rules for Swiss and foreign investment funds.

DL: In addition to the efforts of the tax authorities, FINMA and the Swiss Fund Association have done a great job at responding more actively to the needs of fund promoters. In addition, the Swiss Law on Collective Investment Schemes was comprehensively revised on 1 January 2007. It is now possible to operate Swiss hedge funds under very flexible investment restrictions (borrowing up to 50%, pledge

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up to 100%, leverage up to 600% and short sale permitted). If the fund is aimed at qualified investors only, FINMA may even agree to greater flexibility. Unfortunately, foreign managers are still not fully aware of the flexibility that the new Swiss regulations offer. The law was amended in early 2007 and we are only starting to see an increase of fund launches now, two years later.

GM: The authorities arrange seminars in various financial centres to communicate the advantages of setting up business in Switzerland. This covers how to go about it, making relevant information available on websites and the promotion of organisations which promote their association and members here. For the fund industry there is the Swiss Funds Assocation and the state regulator, FINMA, as well as groups such as Swiss Bankers Association, the Swiss Association of Asset Managers, GSCGI, Genève Place Financière, Friends of Funds and others: most of whom hold regular events of interest to those working in the sector.

HFMWeek: In light of recent events, how can communication between investors and hedge fund managers be improved?

DL: Investors are requesting greater communication, transparency and surveillance. Some hedge fund managers are considering, mutatis mutandis, migrating their offshore funds into an onshore jurisdiction, such as Switzerland. Hedge fund managers are starting to understand that they can make stronger arguments for marketing more regulated and transparent funds. Some effort has also been put into ensuring that the language used in funds' offering documentation is clear and understandable. Considering the risk of litigation, it is in managers' best interests to ensure that investors have understood the underlying strategy, level of leverage and the risk factors.

GM: Certainly there is some need for improved communication. For their part, managers need to follow the standards prescribed by the Hedge Funds Standards Board, Presidents Working Group and AIMA. These standards are in the early stages of being consolidated. Key areas for managers to focus on will be corporate governance and valuation. For investors, more appropriate due diligence is vital, both in terms of operational and investment processes. Intermediaries such as private bankers and FoHFs especially need to improve here, as the Madoff scandal has shown.

PB: Clearly, there are increased demands for transparency on the part of both retail and institutional investors and, in the current marketplace, investors continue to seek the security and peace of mind provided by the engagement of a third-party administrator. Protection and comfort are afforded to investors when a reputable, independent party is controlling cash, executing fund transactions as well as collecting and recording confirmations and NAVs for each investment position. The importance of the administrator's role was also confirmed by Swiss bank UBP's recent move demanding that an administrator be appointed for all sub-funds in its FoHFs.

HFM: What regulatory changes do you see appearing on the horizon?

DL: I believe many jurisdictions will start regulating hedge funds and their managers with greater care. At this stage, only Swiss hedge funds managers are subject to a licence requirement (FINMA may even waive this requirement upon request, if Swiss funds are open for investment to qualified investors only). There has been no announcement at this stage to regulate offshore fund managers operating from Switzerland.

PB: We believe there is a strong possibility that the law that grants regulatory status to asset managers of Swiss funds will be extended to cover those based in Switzerland who are managing foreign funds. An extension of the status for managers of non-Swiss funds would boost the jurisdiction's international competitiveness, however, the move has not yet been confirmed by the authorities.

GM: The Swiss regulator is likely to follow the trend rather than set it. It has already announced a new framework for asset managers who belong to self-regulatory bodies, which is based on the FINMA-controlled one. Along with the rest of the world, I expect Switzerland to enact more regulation and prescriptive controls, hopefully based on the Hedge Fund Standards Board, and ensure stronger enforcement. This may end up being more investor-led. The Swiss regulator will also wait to see how EU regulators move before considering whether to take further action. ■