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Limited Qualified Investor Fund (L-QIF) and investment compliance

The introduction of the L-QIF should be seen in the light of moderate deregulation, which is intended to promote the competitiveness and innovative strength of Switzerland as an investment fund location without having to accept significant losses in investor protection. The new type of fund is aimed exclusively at qualified investors, particularly in Switzerland, who are offered an alternative to foreign fund products (e.g. RAIF). The new regulations in the Collective Investment Schemes Act (CISA) and the associated ordinance (CISO) focus on transparency requirements and less on prohibitions. Consequences for investment compliance can be found in the conclusion of the document and the corresponding chapter covering the consequences for investment compliance.

Definition of the L-QIF

In addition to the characteristics generally applicable to collective investment schemes (assets, investments, collectivity, external management, and equal treatment of investors), the following specific characteristics apply to the L-QIF:

- is only open to qualified investors.
- is managed by a supervised institution (usually a fund management company).
- is neither authorized nor approved by FINMA and is not supervised by FINMA.

The characteristics must be checked regularly by the institution responsible for the management. If a characteristic for the L-QIF is no longer fulfilled, the institution must take immediate action. Commingling with supervised structures (e.g. within umbrella funds, master-feeder structures) as well as restructuring into supervised collective investment schemes are not permitted. A change of status from a supervised collective investment scheme to an L-QIF is possible under certain conditions.

Advantages of an L-QIF

L-QIFs offer several advantages for providers and investors:

- Substantially reduced time-to-market, as no authorization and approval from FINMA is required.
- Cost-effective, as no direct supervision.
- L-QIFs can be set up as contractual investment funds, SICAVs, limited partnerships for collective investment (LPCI), umbrella funds or master-feeder structures.
- Liberal investment regulations, which in principle adopt those for other funds for alternative investments.
- High flexibility in the selection of investments (e.g. less liquid alternative investments such as art or wine are possible) and investment strategies (high complexity through extensive use of derivatives).
- The L-QIF – and now also comparable foreign collective investment schemes – are available to investment foundations as a permissible investment vehicle for traditional and alternative investments and can be acquired as part of BVV2 investments. L-QIFs for the investment of funds as part of securities savings in the vested pension benefits area are excluded. An amendment to the Health Insurance Supervision Ordinance (KVAV) also gives insurers access to L-QIFs for the investment of tied assets, subject to additional conditions.

Obligations for institutes in charge of administration and management of an L-QIF

- The fund documents and advertising for L-QIFs must be clearly labeled so that investors can see at first glance that the fund is not under direct supervision of FINMA. For example, "L-QIFs with real estate investments" may not call themselves "real estate funds".
- L-QIFs are subject to a supplementary audit by the audit firm and must be included in spot checks as part of the institution's supervisory audit. Significant deficiencies – which always include breaches of the regulation on the definition of an L-QIF – must be included in the audit report as objections if necessary. The supplementary audit takes place every 2 years and includes the reporting obligations of the L-QIF.
- Although the L-QIF is highly flexible in terms of asset classes and investment strategies, borrowing is limited to 50%, pledging or securities lending to 100% and total exposure to a maximum of 600% of the net asset value. The scope of investments in target funds must also be mentioned in the prospectus. Additional restrictions listed in the CISO apply to "L-QIF with real estate investments".
- More competencies and responsibility for the fund management company: The institution responsible for managing the L-QIF is itself responsible for complying with the applicable regulations and is given additional competencies, e.g. regarding deadline extensions concerning minimum investment volumes, questions of interpretation and the issuing of specific guidelines for an L-QIF.
- The L-QIFs must be entered and removed from the public register at the Federal Department of Finance (FDF). In connection with this, the responsible institutions are obliged to report specific data.
- In the event of an uncompensated loss resulting from an active breach of the investment regulations, the investment breach must be reported immediately to the audit firm and disclosed to the investors. The disclosure must include a description of both the investment breach and the loss incurred. In addition, all investment violations must be reported in the L-QIF's annual report.

Consequences for investment compliance

L-QIFs are subject to:

- the CISO unless otherwise specified,
- the CISO-FINMA insofar as this is stipulated in the CISO, and
- the relevant AMAS self-regulation (rules of conduct, guidelines for real estate funds, money market funds, valuation of assets and the treatment of valuation errors, calculation and publication of performance, calculation and disclosure of the total expense ratio).

The regulations on risk management, internal control systems and compliance are therefore also applicable to L-QIF, meaning that investment limits must also be regularly reviewed by the responsible institution, as is the case for supervised collective investment schemes. This is explicitly stated in Art. 126h CISO as well as the duty to inform investors, custodian banks and audit firms.

Although specific legal requirements relating to the chosen investment strategy, possible investments, the associated risks, and risk diversification are largely absent, these must be adequately disclosed in the fund documents. It is not sufficient to simply state that you are free to choose your investments and investment strategies. Consequently, it is to be expected that the investment regulations applicable to an L-QIF and listed in the prospectus will be more detailed and complex than those for supervised collective investment schemes.

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We are of the opinion that this will further **increase the demands on investment controlling** and make the **following measures appear necessary**:

- More complex investments and investment strategies tend to increase the requirements for investment compliance and risk management.
- Specific know-how may need to be built up within investment compliance to meet the increased control requirements for exotic investments and investment strategies.
- Investment compliance must be involved in the design of prospectuses for L-QIF at an early stage to avoid control gaps (increased due diligence obligations).
- Need for amendments to directives, manuals, etc. to clearly record control and reporting obligations. For example, the policy on deadline extensions in the competence of the responsible institution should be included therein, or the appropriate deadline for the resolution of active or passive violations in the case of non-liquid investments should be regulated.
- Processes must be adapted in some cases. For example, the possibility of a written notification of active investment violations directly to investors should be considered.
- The documentation of controls and any breaches must be at least as good as for supervised collective investment schemes.

Conclusion:

The L-QIF is a useful addition to the fund structures already available. It will be aimed primarily at Swiss investors. For investment compliance, the requirements in connection with the L-QIF are likely to increase overall.

Other relevant adjustments as part of the revision of the CISO

Measures and information obligations in the event of active breaches of investment regulations in the common provisions: The obligation to immediately reduce to the permissible level is now listed in Art. 67, 2bis CISO. In our experience, this is in line with common practice. If the loss is not compensated, there is a publication obligation as well as the obligation to list all active investment violations in the annual report.

ETF: Art. 106 CISO now contains the legal definition of exchange traded funds (ETFs) and further regulations for actively and passively managed ETFs. In addition, it is now possible for share classes structured as ETFs and non-ETFs to coexist within collective investment schemes.

Liquidity regulations: Art: 108 CISO contains provisions to ensure the appropriate management of the liquidity of collective investment schemes and monitoring by the fund management company or SICAV. Depending on the structure of the processes and responsibilities in a fund management company, this also has implications for investment compliance.

About EPIC Solutions
EPIC Solutions Group is one of the leading consulting boutiques in the areas of investment compliance, investment compliance outsourcing (ISAE3402 certified by PwC), governance and risk management. The company was founded 8 years ago in Switzerland. The client portfolio ranges from small to large international financial service providers, banks and asset managers in Europe and Switzerland. The core competence of EPIC Solutions lies in the area of investment compliance. Business clients receive professional and technical support for projects involving the evaluation, integration, implementation and migration of new investment compliance systems and processes, as well as in-depth quality testing of existing solutions. With its own innovative RegTech app 'etac', an innovative solution for the digitalization and automation of the investment compliance process has been developed, which is already in daily use at various clients.

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