

Domestic Regulations for Investment Funds

Banking & Finance Commission

WS 8 General Report of Switzerland

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1. OVERVIEW OF THE INVESTMENT FUND INDUSTRY

1.1 Some facts and figures

Investment Funds are one of the fastest growing industries in banking. Every year more and more investors choose to invest through Investment Funds rather than directly in bonds or stocks. Some jurisdictions have established themselves as clear leaders of the pack, while others have only started to adapt to international standards. This paper will attempt to give an outlook of the Investment Funds industry by looking at the way they are dealt with in fourteen jurisdictions, namely, Bermuda, the BVI, Canada, the Cayman Islands, Colombia, Finland, Ireland, Lebanon, Luxembourg, The Netherlands, Romania, Spain, Sweden and Switzerland.

The two most important categories of Investment Funds in the world are mutual funds and hedge funds. Mutual funds are traditional (or long only) equity, bond or money market funds (or a mix thereof). They represent USD 17.3 trillion of assets at the end of 2005.

Out of 56'000 Investment Funds registered in the world according to the Investment Company Institute (ICI), almost half (44%) are equity funds.

Hedge funds, although a fast growing category, have only attracted assets representing about 6.5% of the assets invested in Investment Funds worldwide (USD 1.13 trillion invested in about 8'500 funds or funds of hedge funds by the end of 2005).

The majority of hedge funds are registered in offshore jurisdictions (55% of funds representing 66% of assets), with the Cayman Islands, the BVI and Bermuda representing almost 90% of offshore registrations. The place where hedge funds are registered is, however, not necessarily the place from which they are managed. In fact 50 % of hedge funds are managed out of New York and Greenwich and 25% out of London.

Mutual funds are traditionally registered onshore with the US maintaining its leadership boasting 50% of assets invested in mutual funds worldwide. While France and Luxembourg have almost as many mutual funds (in number) as the U.S. (closely followed by Korea...) they each account for only a sixth of the assets (in dollars) held by US mutual funds. This leaves Luxembourg as the second most important mutual fund jurisdiction in the world totalling close to 9 % of the world's assets invested in mutual funds. By adding hedge funds and other categories of funds, Luxembourg was servicing USD 1.85 trillion of assets by the end of 2005.

In comparison, Ireland, one of the fastest developing players, was servicing by the end of 2005 around USD 950 billion, Switzerland and Canada slightly more than USD 400 billion, closely followed by Spain (USD 340 billions) while countries such as The Netherlands (USD 100 billion), Finland (USD 155 billion) and Sweden (USD 165 billion), although mature jurisdictions, were showing comparably lower figures. Interestingly, it is in the Netherlands that the first Investment Funds appeared during the second half of the 18th century.

Emerging jurisdiction such as Lebanon, Colombia and Romania are still well under USD 1 billion.

1.2 Legal personality

Another way to categorize Investment Funds is to distinguish whether they are with or without legal personality. Most civil law jurisdictions offer the possibility to set up an Investment Fund through an incorporated body established by an investment management company under which the investors participate as co owners of the assets of the Investment Fund.

Such Investment Funds do not have a distinct legal personality and are formed by way of a deed of constitution between the investment management company and the custodian. Ireland, Luxembourg, Switzerland, Spain, Finland, Sweden, The Netherlands, Lebanon and Romania all provide for the possibility to set up such Investment Funds under different names (Common Contractual Fund in Ireland, Fonds Commun de Placement in Luxembourg, Collective Investment in Lebanon or simply Investment Fund in other countries).

Anglo-Saxon jurisdictions have developed the concept of Unit Trusts which do not have any legal personality either. The concept of a Unit Trust is similar to that of an Investment Fund in Civil Law jurisdictions. The difference is that the assets of the Unit Trust are held by its trustee (usually the custodian) who will act in a fiduciary capacity to represent the Unit Trust holders. The Trustee may enter into contracts in relation to the assets, for instance to delegate the day to day management of investments to an investment management company. Investors in a Unit Trust do not deal directly with the investment management company as it is the case with an Investment Fund. It is the Trustee's role. Ireland, Canada, the BVI, the Cayman Islands and Bermuda offer the possibility to set up Unit Trusts. Interestingly, Ireland is the only jurisdiction which seems to propose both Unit Trusts and Investment Funds and Finland the only one to propose neither.

When it comes to incorporating an Investment Fund which has its own legal personality, civil and common law jurisdictions seem to have adopted the same rules. Such corporate type Investment Funds (also sometimes referred to as investment companies funds) are usually established by setting up a limited liability company with variable capital (open-end funds) or fixed capital (closed-end funds). The assets are the property of the company in which the investors hold shares. The only countries which do not seem to offer the possibility to set up corporate type Investment Funds are Romania and Sweden.

1.3 Transferability and substance

For those who wish to market their Investment Fund in the European Union, the UCITS Directive proposes a "passport regime" according to which an Investment Fund that has been authorized in one EU Member state as a UCITS Investment Fund can be sold without any further authorization in the other EU Member states. The basic requirement for UCITS

Investment Funds is that at least 90% of the net assets must be invested in listed or soon to be listed (max 10%) transferable securities or securities issued by sovereign states or their local authorities, with no more than a 10% exposure to any one issuer (falling to 5 % in certain circumstances).

Some jurisdictions are more flexible than others in assessing the degree of substance which they require for an Investment Fund to be registered. Others will be stricter and will for instance impose the use of local custodians, administrators and / or local directors or will not allow Investment Funds with just one investor or one underlying investment. In Ireland for instance, the only forms of investments which are allowed to have just one investor or to have a 100% exposure to a single issuer are non-UCITS Unit Trusts.

The BVI, the Cayman Islands and Bermuda have committed themselves to offer great flexibility, speed and comparatively modest costs to establish Investment Funds.

Requirements from each jurisdiction are too diverse to list exhaustively in this paper. They must be carefully reviewed and compared to understand the pros and cons of setting up an Investment Fund in one jurisdiction or another.

2. SETTING UP AN INVESTMENT FUND OR FUND OF FUND

2.1 The parties involved

2.1.1 The investment management company

The overall investment policy of an Investment Fund is incumbent to the board of directors (in case of a corporate type Investment Fund) or to the trustee (in case of a Unit Trust). The day-to-day decisions are normally not taken by the board or the Trustee and are usually delegated to an investment management company.

In case of a contractual type Investment Fund, the investment management company is both laying down the overall investment policy of the Investment Fund and is taking the day-to-day investment decisions, unless this function has been delegated to an investment adviser or sub-investment manager.

In most jurisdictions, there is no requirement for the investment management company to be located in the country of registration of the Investment Fund. On the other hand, the investment management company is usually subject to an approval process by the local Regulator.

Investment Funds registered in Switzerland must have an investment management company with a share capital of at least CHF 1 Mio with its registered office and principal place of administration in Switzerland (investment decisions must take place in Switzerland, as well as accounting, distribution, etc.). The investment management company must obtain an authorization from the Swiss Regulator before starting its business. The managers and the

board of directors must be duly qualified and a distribution licence must be applied for. It is however possible to nominate an investment adviser abroad who is not subject to any authorization procedure in Switzerland as long as such investment adviser does not perform any functions pertaining to the Investment Fund.

In the E.U. capital requirements are lower (EUR 125'000) and in offshore jurisdictions there is usually no minimum capital requirement for investment management companies.

Apart from minimum capital Luxembourg has similar requirements than Switzerland with one notable exception: portfolio management may be delegated to investment management companies outside of Luxembourg.

In the BVI, the Cayman Islands and Bermuda, there is no obligation for the investment management company to be located in the jurisdiction where the Investment Fund is registered. Should the investment management company operate locally, it needs to be licensed. If it is not domiciled locally, it needs no licence provided it is a qualified and authorized manager under the laws of a recognized jurisdiction.

In Finland a foreign investment management company is allowed to manage a Finnish Investment Fund based on an authorization granted in its home state, but such foreign investment management company may not, however, set up an Investment Fund in Finland.

In Ireland the investment management company may be located outside Ireland and will not be subject to an approval process if it is in the Financial Regulator's E.U. Investment Services Directive register.

2.1.2 Administration

In most jurisdictions, administrative duties relating to Investment Funds must be carried out locally, such as the keeping of the register of participants, the processing of issues and repurchases, the drawing up of prospectuses, the preparation of financial reports and of other documents intended for investors, their dispatching, the calculation of the Net Asset Value (NAV) and the account keeping.

Such administrative duties are usually carried out by the investment management company but in many instances they may also be delegated to an administrator. In Luxembourg, Ireland or Lebanon, for example, they are delegated to an administrator which must be locally established, while the investment management company can be situated abroad.

2.1.3 Promoter

In the most established jurisdictions such as Luxembourg and Ireland, it is necessary for an Investment Fund to have a promoter or a co-promoter, that is someone with sufficient

financial resources to satisfy the requirement for indemnification of the Investment Fund and its investors for losses resulting from possible failures, irregularities or insufficiencies identified in the management and administration of the Investment Fund.

The promoter can be the investment management company. The promoter needs to be authorized by the Regulator and must be established locally. The promoter's role is important as the Regulator may request the promoter to indemnify the Investment Fund without attempting to find out whether third party service providers are responsible for the prejudice suffered. The aim is to avoid lengthy procedures and delays in indemnification, leaving it to the promoter to pay and act thereafter against the responsible party.

2.1.4 Custodian

There is more to the custodian's role than merely holding in deposit the assets of the Investment Fund. Its role is also about ensuring that the issue and redemption of the shares to investors are carried out in accordance with the Investment Fund's documentation and relevant regulations, that the shares' NAV is calculated appropriately, that the Investment Fund's income is applied in accordance with the constitutive documents and that appropriate reporting is made to investors.

Although the safe keeping (depository) function can be delegated to a sub-custodian, the custodian remains in charge of the overall control of the assets of the Investment Fund. The custodian must know at all times how the assets have been invested and where and how they are available. The custodian may be held liable for losses which are incurred as a result of a lack of supervision.

Most jurisdictions will require the custodian to be a local bank or a local branch of a foreign bank. Luxembourg does not accept as custodian branches of a foreign bank which does not have a registered office in the EU. Ireland will accept an Irish incorporated company which is wholly owned by a non EU credit institution provided that the liabilities of the Irish company are guaranteed by the parent institution. Finland will accept a foreign credit institution as custodian if it has a branch office in Finland and has been granted in its home state an authorization to act as custodian and has a minimum share capital of EUR 730'000.

In Switzerland the custodian must be a bank within the meaning of the Swiss Federal Banking Act. In the BVI, the Cayman Islands and Bermuda, there is usually no requirement for a local custodian although it depends on the classification of the scheme. In case of a Unit Trust, the custodian's role may be played by the trustee.

2.2 Procedure to set up an Investment Fund

All actors (promoter, management company, administrator, custodian, etc.) must usually be authorized by the local Regulator in advance, although in some instances their approval can be submitted in parallel with the Investment Fund's authorization process.

Once obtained, this approval is usually valid for any further Investment Funds to be established.

The contents of the application will vary from one jurisdiction to the other. Most jurisdictions will require a draft of the prospectus of the Investment Fund, a copy of the agreements to be entered with the different service providers (custodian, administrator, management company, etc.) and a copy of the constitutive documents (articles of incorporation for a corporate Investment Fund, trust deed for a Unit Trust).

In Luxembourg, information must be filed on the proposed marketing method, on the countries of marketing, on the targeted investors, on the risk management process, on the human and technical resources at the disposal of the investment company, on the manner in which the management, administration and distribution functions will be monitored, etc.

In Sweden a business plan must be submitted together with the application for authorization and must be updated if necessary throughout the life of the Investment Fund. The business plan shall describe the Investment Fund's operation and rules, the ownership structure, the management structures, and the financials of the Investment Funds.

In Lebanon to set up a domestic Investment Fund, a minimum of one third of the shares must be owned by Lebanese shareholders for the authorization to be granted. The performance of the Investment Fund must be submitted to the Central Bank periodically.

The time frame for an authorization to be delivered varies from one country to the other. In Romania, Finland and Sweden, it will take up to six months, in Spain one month, in The Netherlands 2 to 3 months, in Ireland less than 2 months and in BVI, the Cayman Islands and Bermuda, as little as a week, whereas in Switzerland the process is likely to take well over 6 months.

3. DISTRIBUTION OF INVESTMENT FUNDS

3.1 Main requirements

In EU countries a distinction is drawn with respect to the origin of the Investment Fund applying to be distributed, in particular whether it is a UCITS or a Non-UCITS Investment Fund. Pursuant to the UCITS passport, an Investment Fund which has been approved for distribution in one EU jurisdiction can be distributed in other EU jurisdictions without further authorization requirement (only a written notification with information and documentation on the Investment Fund to the local Regulator is required).

If the local Regulator has not denied the commercialisation of the Investment Fund within a two month period after the filing of the notification, on the basis that it is not in line with the UCITS Directives, the Investment Fund may commence the marketing of its shares or units.

Non-UCITS can also be distributed in EU countries but will need to go through an approval procedure with the local Regulator. The approval will typically be granted if the Investment Fund is subject to an equivalent prudential regulation in its country of origin.

In Luxembourg, foreign Non-UCITS may be registered only if they are subject to permanent supervision by a supervisor authority in their home state.

In Ireland, if no such authority exists, a Non-UCITS may still be marketed if it can satisfy the Financial Regulator that it offers a similar level of investor protection to that provided to Investment Funds authorized in Ireland.

Non Irish domiciled Investment Funds that are regulated by a recognized jurisdiction may list on the Irish Stock Exchange. Investment Funds domiciled in unregulated jurisdictions may still list if they restrict the marketing of shares / units to sophisticated investors. Recognized jurisdictions include Bermuda but not the Cayman Islands and the BVI.

In Sweden a Non-UCITS Investment Funds may market and sell units if the home state Regulator has consented to the establishment of the undertaking in Sweden.

Although it is possible to register Non-UCITS Investment Funds for distribution in Spain, hardly any have been authorized to date, and those which have are restricted to sophisticated investors.

Private placements (Investment Funds which are not marketed by way of a public offer) are usually not required to be registered, whether foreign or domestic.

Luxembourg has, however, taken the view that private placements of foreign UCITS require their prior registration in Luxembourg.

Switzerland will exempt from registration certain categories of private placements:

- Investment Funds offered to no more than 20 investors;
- Investment Funds offered and sold to institutional investors;
- Investment Funds subscribed by investment professionals for their clients under a discretionary asset management mandate.

In Bermuda, the BVI and the Cayman Islands, domestic Investment Funds are usually prohibited from being distributed to local residents. Foreign Investment Funds may however be distributed without restrictions.

3.2 Authorized distributors

Is it enough for an Investment Fund to be properly registered or authorized in order to be legally distributed? In most countries the distributor of the Investment Fund must also be authorized to act as such. When the distribution of the Investment Fund is performed

directly by the Investment Fund manager or its representative, no further authorization is required in addition to the Investment Fund management authorization (which includes the authorization to offer and sell the Investment Fund). If the distributor is a third party an authorization will typically be required. In The Netherlands for instance the offering of investment products beyond closed circles without a licence is even qualified as an economical criminal offence.

In Canada, those who sell Investment Funds must be registered as dealers or salespersons (as opposed to those who make investment decisions for Investment Funds and who are registered as advisors). Many dealers are members of one the industry's five self-regulated organizations.

In Lebanon, Investment Funds are distributed mostly by custodian banks. As in most countries a proper banking licence includes the right to distribute Investment Funds, so that no further authorization is required from a Lebanese bank to distribute Investment Funds.

In Colombia, it is mandatory to have an authorized representative office in Colombia to distribute Investment Funds.

In the BVI, no specific licensing requirements are applicable to distributors of Investment Funds, except if they have a physical presence in BVI, in which case they need to obtain a trade licence and a work permit.

In Switzerland, a licence is required to distribute Investment Funds with the exception of those Investment Funds which are themselves exempt from an authorization for distribution (see the categories of exempt Investment Funds under section 3.1). No distributor authorization is required to distribute such funds but only to the extent, however, that no use is made of media advertisement, mass mailing or cold calling. Road shows and seminars are authorized but only for institutional investors to attend.

In Ireland distributors must be authorized by the local Regulator or under an equivalent legislation in another EU Member state and must have been "passported" into Ireland to provide those services.

It is useful to have a precise understanding of the definition of Investment Fund distribution as it exists under the laws of each jurisdiction. Such definition is usually part of the broader concept of "investment advice" and will typically cover "the giving or offering or agreeing to give, to any person advice on the purchasing, selling, subscribing for underwriting, of investment instruments" (EU Investment Service Directive (93/22/EEC))

3.3 Marketing an Investment Fund

Most countries have enacted advertising standards, the main requirement of which is that advertising material must be fair, truthful and transparent. Generally speaking, the principle is that investors should have access to all relevant information in making their investment decision whenever an Investment Fund is proposed to them by way of a public offer.

In Ireland for instance the Code of Advertising Standards requires that all publicity comprising an invitation to purchase the shares of an Investment Fund or the units of a Unit Trust must indicate that a prospectus exist and the places where it can be obtained.

A foreign UCITS Investment Fund which intends to market its shares / units in one of the Member states of the EU must submit to the local Regulator its latest annual report and the subsequent half yearly reports. The typical requirements are indeed a prospectus to inform of the specifics of the Investment Fund at the time when the decision to invest is to take place and an annual or semi annual report to provide updates on the latest developments of the Investment Fund.

If an offer of shares / units is structured in such a way as it will not be deemed an offer to the public under the applicable domestic rules, many of the relevant requirements can be avoided. The definition of public offer *versus* private placement must be carefully analyzed in each country where an Investment Fund is meant to be distributed to determine whether the manner in which the offer is structured falls within such obligations as to prepare and file a prospectus, to have the Investment Fund registered and / or to obtain a licence for its distribution.

In Sweden for instance the concept of marketing includes all advertisement and other measures in the course of commercial activities which are intended to promote the sale and the access to products and services, including any advertising, either through mass media or through direct advertisement, issuing of promotional material, electronic marketing through a website or through an e-mail campaign and telephone marketing¹.

In Finland marketing material must be in Finish or Swedish. Another language may only be used on the basis of a permission granted by the Finish Regulator.

¹ Swedish Marketing Practice Act

3.4 Rebates / Retrocessions

Rebates received by the Investment Fund manager should be paid to the Investment Fund and not be kept by the investment manager. Such rebates are typically negotiated by the investment manager of the Investment Fund with the brokers or dealers to whom orders are passed for the purchases and / or sales of securities derivatives or techniques and instruments for the Investment Fund.

In some jurisdictions it is required that such arrangements be disclosed in the prospectus. The general idea is that the common interest of the share / unit holders of the Investment Fund must be protected. Such disclosure is compulsory in Ireland and The Netherlands for example.

Rebates may also be paid-out by the Investment Fund to distributors of the Investment Fund. In most jurisdictions, it is considered as standard industry practice to pay rebates out of the management fee to dealers in order to facilitate the distribution of an Investment Fund.

On the other hand, investors are entitled to fair and impartial advice from dealers and brokers as to which Investment Funds to choose. In order to minimize conflicts of interest some jurisdictions have enacted legislation to prevent certain sales practices and compensation arrangements that could undermined, compromise or conflict with the fundamental obligations that are owed by the industry participant to investors.

Canada for instance prohibits the following practices:

- Sales contest held by Investment Fund companies for dealers or their representatives to qualify for additional bonus commission payments;
- All expenses paid fund company-sponsored conferences having limited educational purposes, where attendance is dependent upon achievement of certain sales levels;
- Unlimited marketing allowances set up by Investment Fund companies to permit dealers or their representatives to pay for certain of their business expenses, provided certain asset or sales levers are achieved;
- Payment of commissions (whether upfront or trailing) contingent on the dealer or representative achieving a specific asset or sales level.

In any event some jurisdictions, such as Canada and Bermuda require that arrangements to pay rebates out of the Investment Fund be disclosed in the prospectus. Other jurisdictions such as Switzerland or the Cayman Islands require that the financial intermediaries receiving the rebate disclose its receipt to the investors to whom they distribute the Investment Fund. Some jurisdictions have not enacted any regulations in this respect, whereas certain countries, such as Lebanon, simply prohibit any kind of retrocession.

4. INVESTING IN AN INVESTMENT FUND

4.1 The various categories of investors

Most countries distinguish between retail investors and sophisticated investors. The idea is that some Investment Funds are more complex and should only be accessible to sophisticated investors.

As a matter of fact, the distinction occurs in terms of the types of Investment Funds rather than the types of investors. Indeed certain Investment Funds are geared towards retail investors while others are geared towards sophisticated investors. As a logical consequence, one might observe that the registration process and the ongoing obligations applicable to an Investment Fund geared towards retail investors are a lot stricter than those applicable to Investment Funds geared towards sophisticated investors.

In Switzerland for instance, an Investment Fund needs not be authorized for distribution and no license is required from the distributor of the Investment Fund if it is offered to a limited number of investors (no more than 20), if it is offered and sold only to institutional investors or subscribed by professional investors on behalf of their clients.

In Finland Investment Funds which only accept professional investors are not subject to certain marketing and operational requirements under Finnish law.

Ireland distinguishes three categories of Investment Funds:

- The Retail Investor Fund which has no minimum subscription or imposes a minimum of less than EUR 125'000;
- The Professional Investor Fund which has a minimum subscription of EUR 125'000;
- The Qualifying Investor Fund which has a minimum subscription of EUR 250'000;

Retail Investor Funds may not invest more than 20% of NAV in the securities of any one issuer and borrowings cannot exceed 25% of NAV, whereas Professional Investor Funds may borrow up to 100 % of the NAV. Qualified Investor Funds can only be sold to institutional investors which own or invest at least EUR 25 MIO or to individuals with a minimum net worth of EUR 1.25 MIO.

In Luxembourg, Investment Funds offered to institutional investors are subject to a more flexible regime as well. This regime is under a project to become even more liberal and to be extended to professional investors and sophisticated retail investors.

4.2 Protection of investors

As seen above retail investors benefit from more stringent measures to protect them in their investments. Whereas the requirement to produce a prospectus, to publish annual or semi annual reports, to make public the issue and redemptions price of units / shares are often waived when it comes to Investment Funds geared towards institutional, professional or sophisticated investors, they are always mandatory for Investment Funds geared towards retail investors.

The local Regulator is usually in charge of controlling that the measures designed to protect investors are carried through to satisfaction. The local Regulator is assisted in his functions by the auditors of the Investment Fund and the custodian and / or the administrator. The management company, but also these other counterparts, may be held liable for compensating damages caused by the violation of their obligations.

In Finland investors have a right to elect at least one third of the members of the board of directors of the management company and to participate in the election of the auditors.

Each country has rules regarding the information which an Investment Fund is required to make available to investors. Colombia for instance offers a good example of a very detailed and elaborate investor protection regime:

Title five of the new Securities Law (964, 2005) contains precepts regarding (i) the content of the shares placement rules (reglamento de suscripción de acciones), (ii) the procedure that has to be given to the proposals made by various investors representing at least five percent or more (5 %) of the subscribed shares, (iii) the reacquisition of shares and subsequent transfer, (iv) the requirements of the shareholders agreements, (v) the duties and rules for the securities issuer and the registered companies. And in title six of the Law there is a list of the infractions and disciplinary penalties applicable to the agents that disobey the decisions of the Financial Superintendence.

Among others, the External Resolution (Circular Externa) 036, 2003 of the Financial Superintendence establishes consumer protection rules like the periodicity in which the trustees have to divulgate the net yield of their Investment Funds, and chapter I, title V of the External Resolution (Circular Externa) 007, 1996, gives a complete set of rules regarding consumer protection, including the information that has to be published in the web page of the entity, in newspapers or in other suitable ways, like the periodical net yield, the management fee and the composition of the portfolio of investments. This Resolution presents a form that has to be filed by the trustees with the basic information of each Investment Fund. This form has to be actualized on a monthly basis and has to be published in the web page of the company, or in a similar way. It also has to be sent to every investor of the Investment Fund semi annually.

In Canada the Canadian Investor Protection Fund is a contingency fund that provides coverage of up to USD 1 million per client account in the event of the insolvency of

dealers who are members of the Fund. A similar Bank guarantee fund exists in Romania whose members are the financial services companies.

In Ireland the Financial Regulator maintains a register (and publishes once a year a list) of authorized Unit Trusts, contractual and corporate type Investment Funds.

4.3 Single investor funds

Many jurisdictions provide for the possibility to set up an Investment Fund for just one investor. Such is the case in Ireland, Luxembourg, Sweden, Canada and Lebanon.

For example: In the BVI, the Cayman Islands and Bermuda, not only is it possible to set up single investor funds, but also such funds will not fall within the definition of a mutual fund and will therefore not be subject to local laws and regulations. In Colombia, it is only possible for foreign Investment Funds to have one investor, whereas in Finland closed-end Investment Funds (with one or several investors) are simply not allowed.

4.4 Information to investors / standards of performance measurement

Sweden is a good example of the clear and broad spectrum requirements by which an Investment Fund should ideally abide in terms of information to its investors.

An information brochure and a fact sheet are compulsory according to Swedish law in respect of each Investment Fund. The information brochure must contain:

- (i) the fund rules;
- (ii) any additional information required in order to be able to assess the fund and the risks associated with investing in the fund;
- (iii) a clear and readily understandable explanation of the risk profile of the fund; and
- (iv) information regarding the services and functions which are offered.

The fact sheet shall, in a readily understandable and summarized manner, contain basic information required in order to be able to assess the fund and the risks associated with investing in the fund. The fact sheet shall be appended to the information brochure as a detachable part.

In addition, the information brochure and the fact sheet for an Investment Fund shall state:

- (i) the types of assets in which the fund's assets may be invested; and
- (ii) whether the fund's assets may be invested in derivative instruments and, in such case, for which purpose and the manner in which the potential results of the use of derivative instruments may affect the risk profile of the fund.

The following information shall be presented in a prominent place in the information brochure and the fact sheet as well as in all other advertising material:

- (i) the investment focus of the fund in the event fund assets will be invested in assets other than transferable securities and money market instruments or where the fund is an index fund pursuant to the Swedish Investment Funds Act; and
- (ii) whether the fund's value may vary significantly due to the composition of the fund or the management methods used by the management company; and
- (iii) where the fund is a special fund, such fact must be stated in the information brochure, fact sheet, and all other advertising information regarding the fund.

Furthermore, the Swedish Investment Fund Association has issued guidelines for the presentation of a fund's performance. The calculation of performance shall be based on the net asset value of the fund, i.e. taking into consideration management fees and other administrative charges. In respect of funds that pay dividend, re-invested dividend should be taken into account as if invested on the day of the dividend being paid. Calculations of the annual mean growth of the fund should be made by using the geometric mean.

For funds investing in money market securities the fund manager may use either interest rate or effective interest rate in calculating track performance, as long as the methodology is described. When presenting and comparing track performance the following should be observed:

- (i) the presentation/comparison shall be in accordance with market practice and not be misleading;
- (ii) the various parts of the presentation/comparison should be selected in a fair way and be built on verifiable facts;
- (iii) if a comparison is made with another savings form, the principles for the comparison shall be described and such principles should be comparable with those applied to the other savings form;
- (iv) administrative charges that are not part of the calculations should be presented;
- (v) if a comparison is made with an index, such index must be specified and relevant to the fund, e.g. the track performance and the index should be expressed in the same currency;
- (vi) if a comparison is made with mean values the selection principles should be presented together with information whether the mean values are weighted or not; and
- (vii) comparisons between funds based in different countries should include a statement stating that different tax rules have not been considered.

Graphical presentations should give a fair and correct picture. A presentation of track performance may not contain or refer to a certificate or a recommendation, which can not

be verified or is out-dated or otherwise misleading. The presentation of the track performance should cover a 'rolling' 12 or 36 months. If another term is used, the presentation should be supplemented by the track performance for the last five years or as from inception. If investments in the fund are presented as tax deductible, future taxation of payments from the fund shall be presented as well. The Swedish Market Court has in a few rulings construed the concept of good commercial standards with respect to the marketing of funds. In connection therewith, the Swedish Investment Fund Association guidelines described above have been considered important in such construction.

In addition to the above, under a recent agreement between the Swedish Investment Fund Association and the Swedish Consumer Agency the following legend (or a similar legend) shall be included in any marketing material relating to funds:

'Historical performance is not a guarantee for future performance. Investments made in the fund may increase as well as decrease in value, and it cannot be guaranteed that your initial investment will be returned in its entirety.'

Even though the inclusion of the legend is not mandatory for marketing materials distributed by foreign fund managers in Sweden, it is recommended that such marketing materials, if practicable, should include the above legend or a similar legend that informs potential investors of risks attributable to investments in fund shares.

Information about costs levied by Investment Funds from investors is usually also required.