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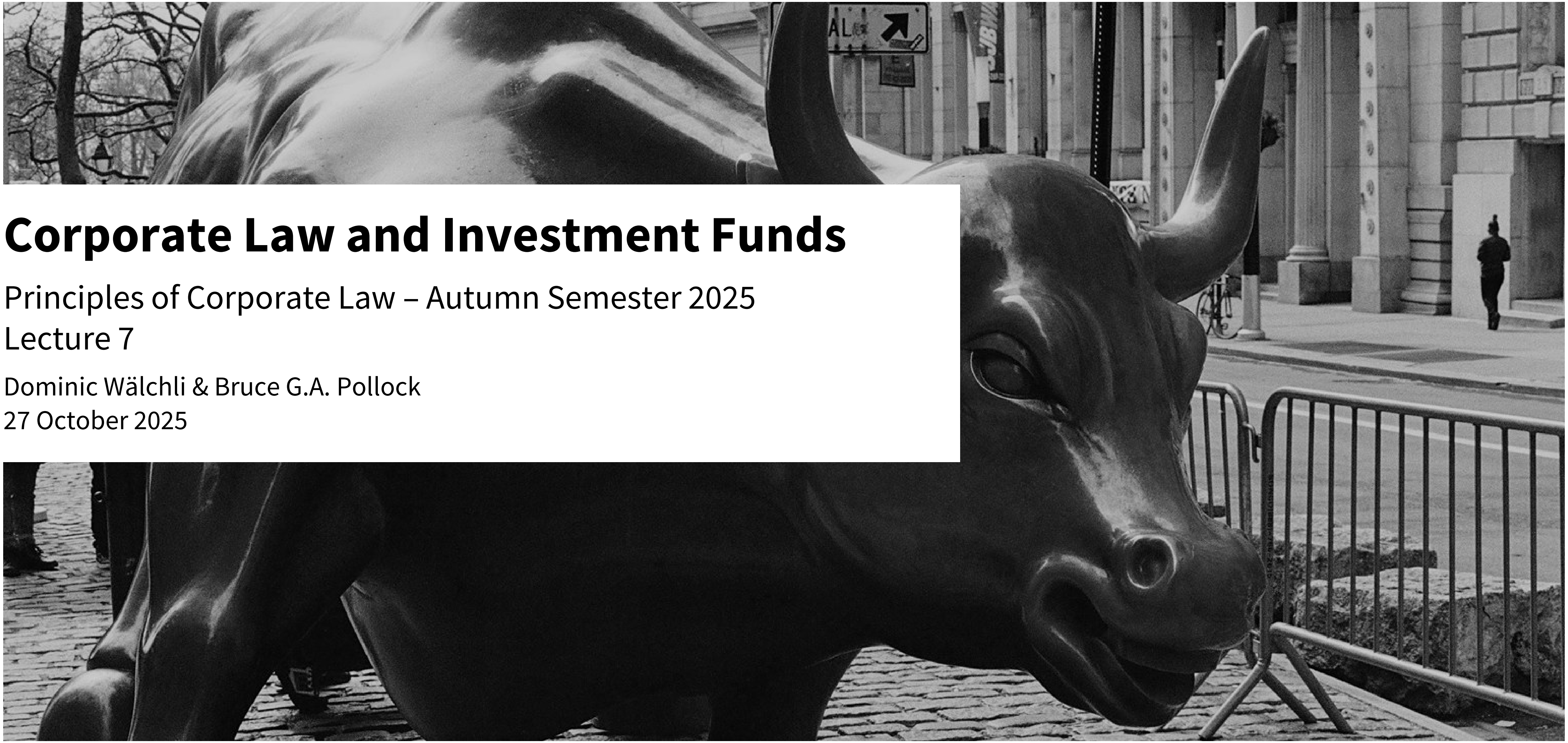

Corporate Law and Investment Funds

Principles of Corporate Law – Autumn Semester 2025
Lecture 7

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27 October 2025

Content
Corporate Law and Investment Funds

Definition and types of funds, including legal forms and asset-based distinctions

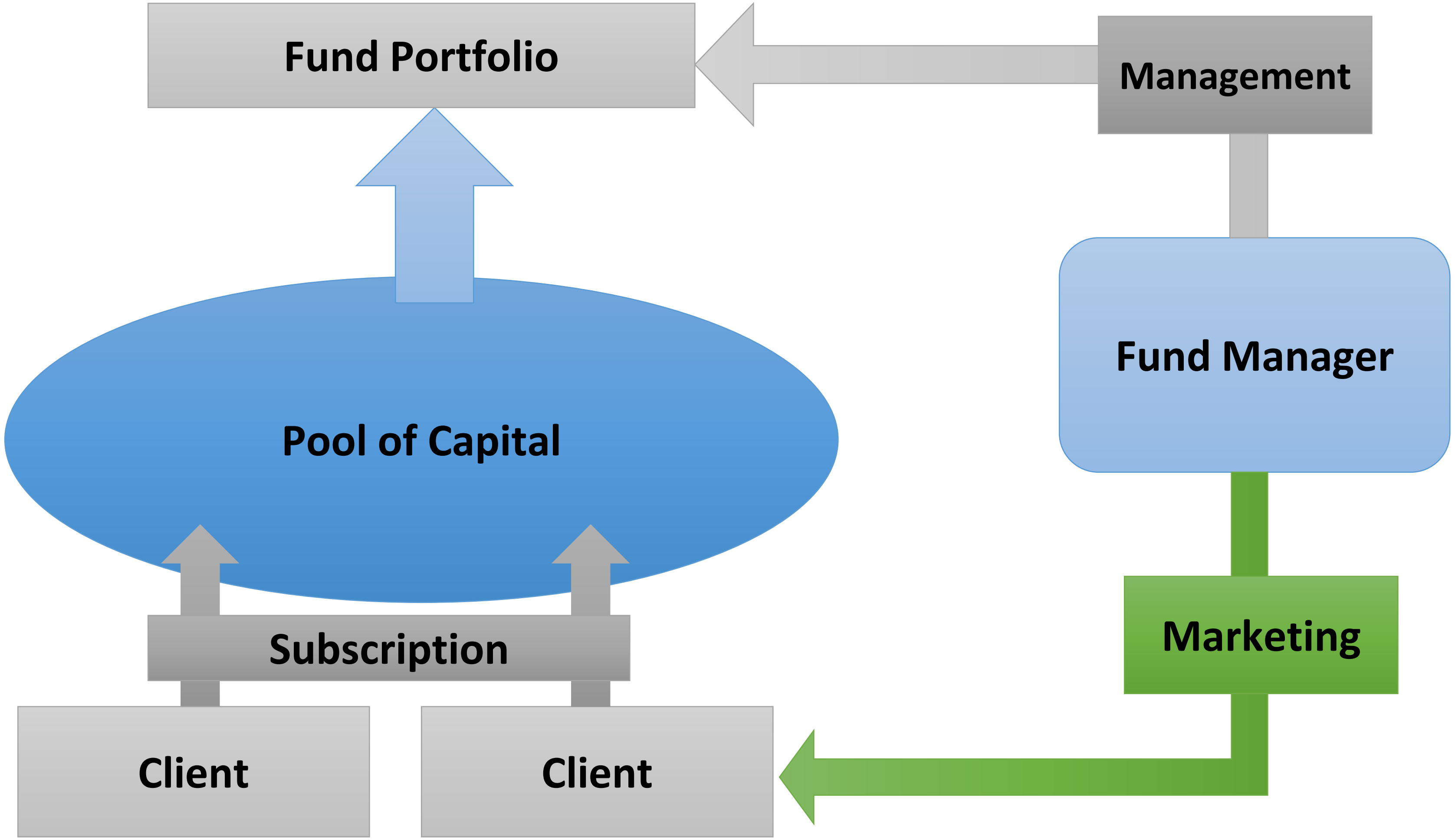
1

The legal definition of investment fund differs by jurisdiction

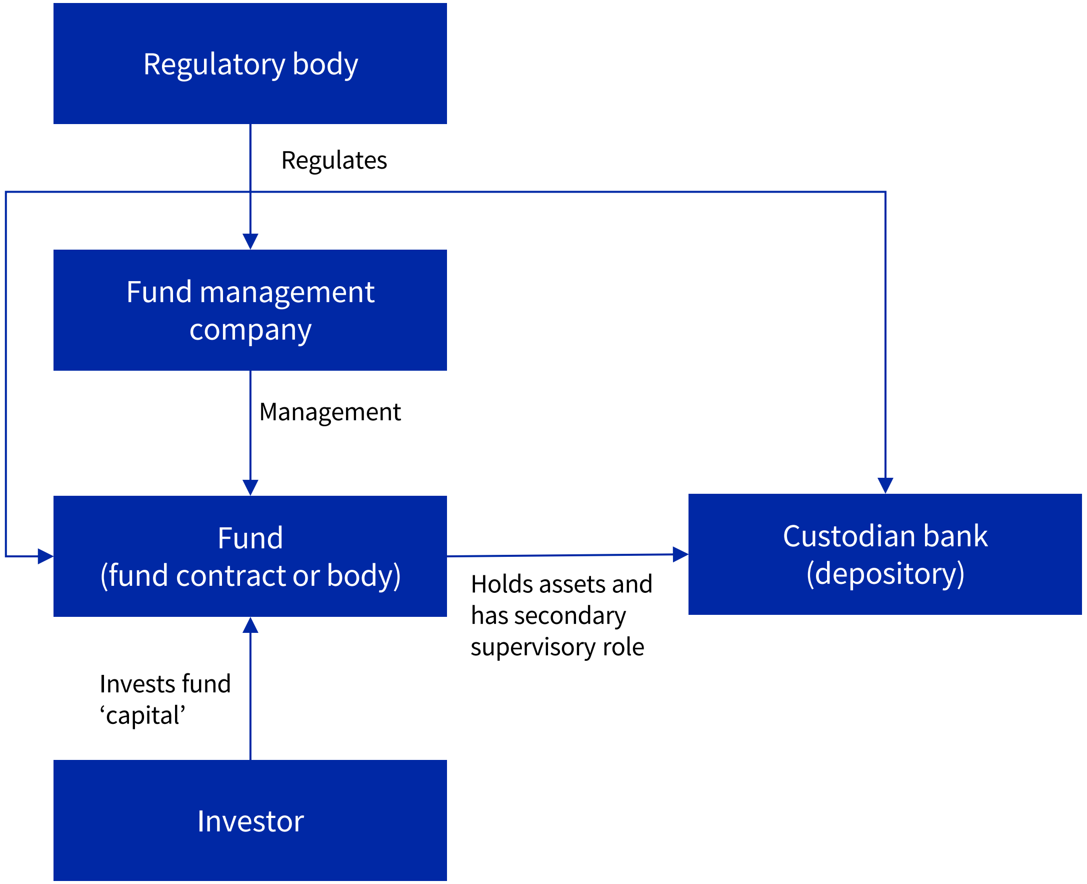
Switzerland	European Union	United States
Assets raised from investors for the purpose of collective investment, which are managed for the account of such investors	Undertaking with sole object of collective investment of assets raised from public managed by a management company	investment company pooling money from many investors investing these funds into assets managed by an investment adviser

Common elements: pooled assets, collective investment, third-party management

Collective asset management: a pool of assets is managed by a manager for investors



Multiple Parties & Players are involved in the fund management and provision process



1. **Regulatory body**
   – Licensing and on-going supervision
2. **Fund management company**
   – Investment management and fund administration
3. **Custodian bank / Depository**
   – Holds assets and ensures compliance with regulation and fund documents
4. **Fund**
   – Vehicle in which collective assets are pooled
5. **Investors**
   – Provide assets

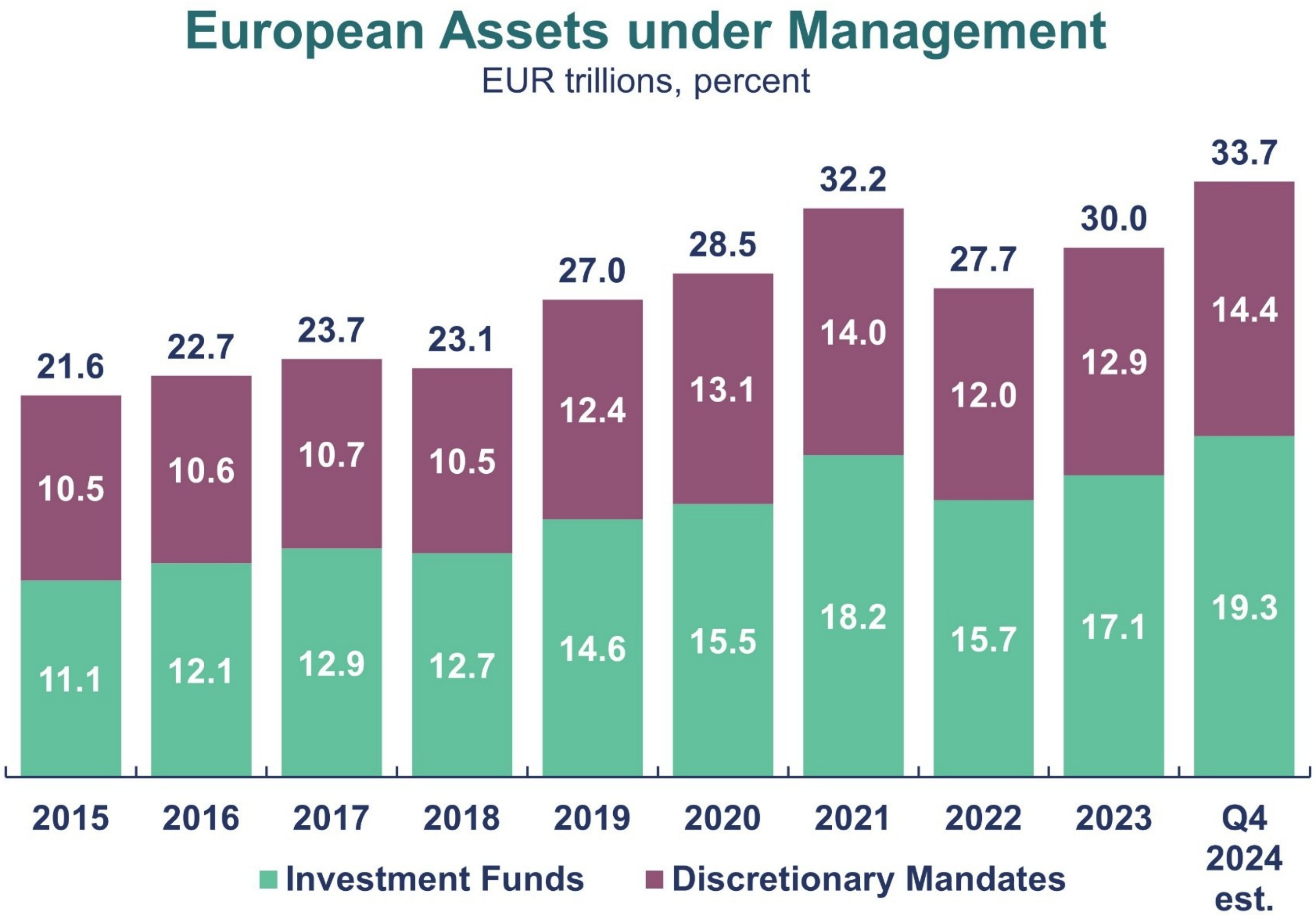
Types & Characteristics of funds can be structured in various ways

by asset class	by investor types	by management type	by redemption rights
traditional vs alternative	qualified vs retail	active vs passive	open vs closed
traditional: securities	qualified: hedge fund	active: hedge fund	open: ETF
alternative: real estate	retail: ETF	passive: ETF	closed: SICAF

Economic rationale for funds and their role in reducing transaction costs

2

Assets under management in investment funds is consistently growing and is predicted to have reached EUR 33.7 trn by Q4 2024



Source. EFAMA, ‘Our industry in numbers’ <https://www.efama.org/about-our-industry/our-industry-numbers>

Four concepts are crucial for our understanding of investment fund regulation

Basic principles and concepts to understand investment funds and regulation

The Time Value of Money	Risk-adjusted returns and the efficient frontier	The Efficient Market Hypothesis	The Principal-agent problem
			

The time value of money is the bedrock of our financial system

Core points:

- CHF 100 today will be worth more in a year’s time, even more in two years etc.
- Concurrently, CHF 100 multiple years from now is worth <100 today.
- The underlying assumption is that, given investment opportunities, cash can be invested profitably over a certain time horizon (we are currently excluding effects of (hyper-)inflation and negative interest rates).
- In order to calculate future values, we would need to know the interest rate.
- To understand what a certain future cash flow is worth today, we also need to understand a type of “interest rate”, referred to as the discount rate.
- A good approximation for understanding how quickly an investment will double in value is “the rule of 72”. 72/r (r is the interest rate) will provide the approximate number of years until an investment doubles.

The time value of money is the bedrock of our financial system

- The time value of money (TVM) is a core financial principle that states a sum of money is worth more now than in the future.
- The fundamental reason, as we saw on the last slide, is opportunity cost: money you have today can be invested to earn a return.
- When we calculate a discount rate for a real-world investment (like in a DCF), we are building a rate that accounts for three distinct factors:
  1. **Opportunity Cost (The "Real" Rate): This is the base return you'd demand for giving up your money, even in a world with no inflation or risk.**
  2. **Inflation:** We add a premium to compensate for the fact that the future money we get back will have less purchasing power.
  3. **Uncertainty (Risk Premium):** We add another premium to compensate for the risk that we might not get the promised money at all.

$$FV = PV\left(1+\frac{i}{n}\right)^{n\times t}$$

where:

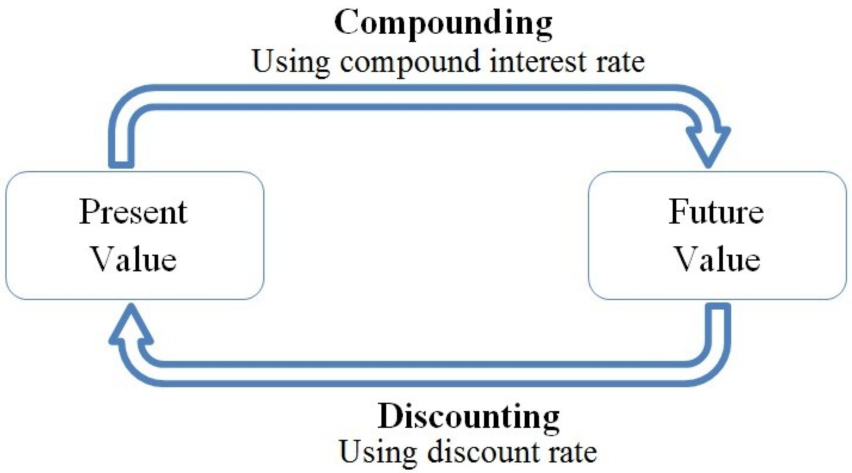
FV = Future value of money

PV = Present value of money

i = Interest rate

n = Number of compounding periods per year

t = Number of years



Harvard Business School, 'Time Value of Money: A primer' (HBS Online 2025) https://online.hbs.edu/blog/post/time-value-of-money
Penn State, 'Discounting and Compounding', https://www.e-education.psu.edu/eme460/node/654
Investopedia, 'Time Value of Money', <https://www.investopedia.com/terms/t/timevalueofmoney.asp>

What the time value of money tells us about investing (and stock values)

Core points:

- A DCF calculation is fundamentally no different from discounting cash to today, except it involves discounting multiple assumed cash flows and an assumed discount rate. We also will add a terminal value (quasi perpetuity) for all future cash flows.

- All this means is: “what would I pay for this company?” and by extension, **“what is the fundamental value of this company’s stock worth?”**

- The basic principles of a DCF calculation are applicable to many asset types: essentially, we are computing likely future cash flows from the asset and calculating its current value

- Accordingly, the accounting definition of an asset fits perfectly in this case (IFRS): An asset is **a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise**.

What the time value of money tells us about investing (and stock values)

$$FV = PV\left(1+\frac{i}{n}\right)^{n\times t}$$

where:

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Discounted Cash Flow Formula

The formula for DCF is:

$$DCF = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \frac{CF_n}{(1+r)^n}$$

where:

CF_1 = The cash flow for year one

CF_2 = The cash flow for year two

CF_n = The cash flow for additional years

r = The discount rate

$$\text{WACC} = \left(\frac{E}{V}\times Re\right) + \left(\frac{D}{V}\times Rd \times (1-Tc)\right)$$

where:

E = Market value of the firm's equity

D = Market value of the firm's debt

$V = E + D$

Re = Cost of equity

Rd = Cost of debt

Tc = Corporate tax rate

Valuation with the WACC method									
Valuation of Nvidia									
Date of valuation: 28 January 2024	**Assumptions**		**28/01/2024**	**28/01/2025**	**28/01/2026**	**28/01/2027**	**28/01/2028**	**28/01/2029**	
Years from 28 January 2025	**Per Year**			**1**	**2**	**3**	**4**	**5**	
(1) Net Sales	0.63	Historical average 2022-2024	*60'922*	99'303	161'864	263'838	430'056		
(2) COGS	0.32	average 2022-2024	*16'621*	31'777	51'796	84'428	137'618		
(3) Depreciation & Amortization	0.05		*0*	4'965	8'093	13'192			
(5) Gross Income = (1) - (2) - (3)			*44'301*	*62'561*	*101'974*				
(6) SG&A	0.1	average yearly	*2'654*	9'930	16'186				
(7) R&D expense	0.2	(2023-2024 development)	*8'675.00*	19'861					
(8) EBIT = (5) - (6) - (7)			*32'972*						
(9) Tax	0.17	estimate for 2025 in CFO report							
(3) Depreciation & Amortization								35'050	
(10) Operating Cash Flow = (8) - (9) + (3)								**227'051**	
(11) CapEX	0.04						17'202	28'040	
(12) Net Working Capital	0.4					105'535	172'022	280'396	
(13) Change in Net working Capital						40'790	66'487	108'374	
(14) Free Cash Flow to Enterprise = (10) - (11) - (13)					**20'929**	**34'114**	**55'606**	**90'637**	94'263
WACC	**0.11651534**								
Terminal Value = FCF(Year H+1)/(WACC-g)	**0.04**	above country growth rate, shouldn't really be possib… petuity						**1'231'945**	
Discount factor				0.896	0.802	0.718	0.643	0.576	
PV FCF (Near Term Business)			**149'187.28**						
PV Terminal Value			**710'015.67**						
Enterprise Value from Operations (EV operations)			**859'202.95**						
Excess cash			7'280.00						
Enterprise Value (EV)			**866'482.95**						
Debt value			22'750.00						
Equity Value			843'732.95						
Number of shares outstanding (m)			24'612.00						
Equity value per share			**34.28**						

Example!

Source: Corporate Finance Assignment, Judge Business School 2025 (on file with author)
Investopedia, DCF, https://www.investopedia.com/terms/d/dcf.asp
Investopedia, WACC, <https://www.investopedia.com/ask/answers/021615/how-do-you-calculate-proper-weights-different-costs-capital.asp>

A quick thought experiment will help us grasp the underlying principles of investment and portfolio management

Initial Investment: CHF 20’000				
1	2	3	4	5
Your savings account	A very safe loan (bond)	Your favourite stock ETF	Your friend’s hedge fund	Your best friend’s startup
Annual return 3% / 0%	Annual return 4.5% / -3%	Annual Return 10% / -5%	Annual return 25% / -40%	Annual return: 1000% / -99.5%
P: 100%	P: 90% / 10%	P: 85% / 15%	P: 67% / 34%	P: 10% / 90%

A quick thought experiment will help us grasp the underlying principles of investment and portfolio management

Investment	Amount	Returns	P	P*	Returns P*	RoI 1	Roi 2	ER	EV
Savings account	CHF 20’000.00	3%	100%	0%	0%	CHF 600.00	CHF -	CHF 600.00	CHF 20’600.00
Loan	CHF 20’000.00	5%	90%	10%	-3%	CHF 810.00	CHF -60.00	CHF 750.00	CHF 20’750.00
ETF	CHF 20’000.00	10%	85%	15%	-5%	CHF 1’700.00	CHF -150.00	CHF 1’550.00	CHF 21’550.00
hedge fund	CHF 20’000.00	25%	67%	33%	-40%	CHF 3’350.00	CHF -2’640.00	CHF 710.00	CHF 20’710.00
Startup	CHF 20’000.00	1000%	10%	90%	-99.5%	CHF 20’000.00	CHF -17’910.00	CHF 2’090.00	CHF 22’090.00

Source: Author’s own calculations.

A quick thought experiment will help us grasp the underlying principles of investment and portfolio management

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P: 100%	P: 90% / 10%	P: 85% / 15%	P: 67% / 34%	P: 10% / 90%
CHF 20’600	CHF 20’809	CHF 21’550	CHF 20’710	CHF 22’090

A quick thought experiment will help us grasp the underlying principles of investment and portfolio management

Initial Investment: CHF 20’000

1	2	3	4	5
Your savings account	A very safe loan (bond)	Your favourite stock ETF	Your friend’s hedge fund	Your best friend’s startup

Core points:

- One simple way to think about such an investment is how much risk one is able/or willing to take on to receive a specific return
- A more complicated way to think about it is a mean-variance analysis, i.e. “what is the mean/average return and how much does this vary from one period to the next?
- Finally, what we have not examined here is how much information do I have about each asset? Are some assets and markets more opaque than others? And how liquid is each asset, is there a premium given due to the fact that I cannot sell it within a certain time frame?

The expected return of an asset, given its risk, can be calculated with the CAPM

$$ER_i = R_f + \beta_i(ER_m - R_f)$$

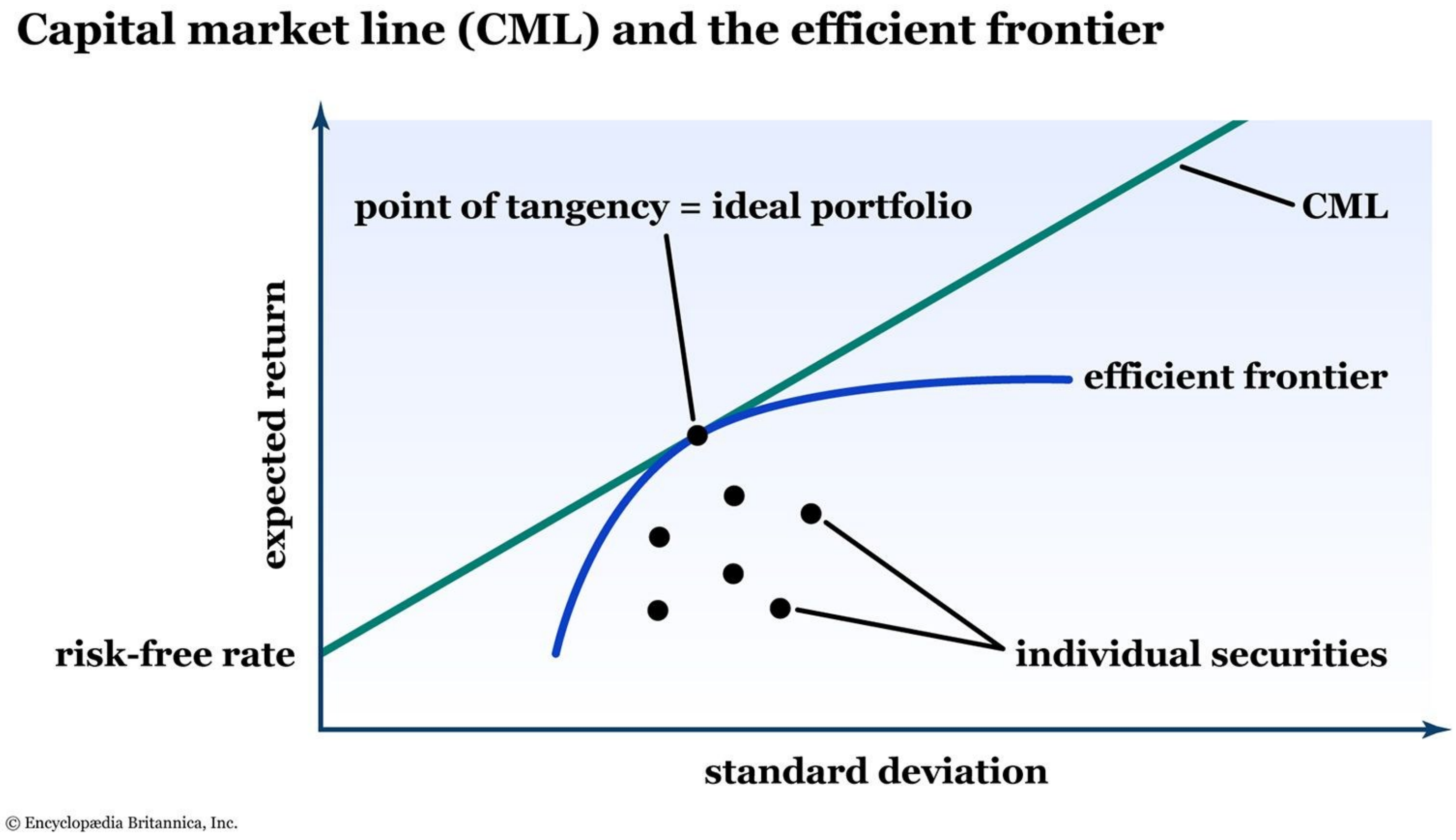
where:

ER_i = expected return of investment

R_f = risk-free rate

β_i = beta of the investment

$(ER_m - R_f)$ = market risk premium



Core points:

- There is an optimal balance between risk and return for any combination of risk appetites, represented by the efficient frontier.
- Any portfolio not on the efficient frontier is not efficient or suboptimal (either too much risk for a given return or vice versa)
- This idea is closely connected to **the diversification benefit in investing (the only free lunch in finance?)**

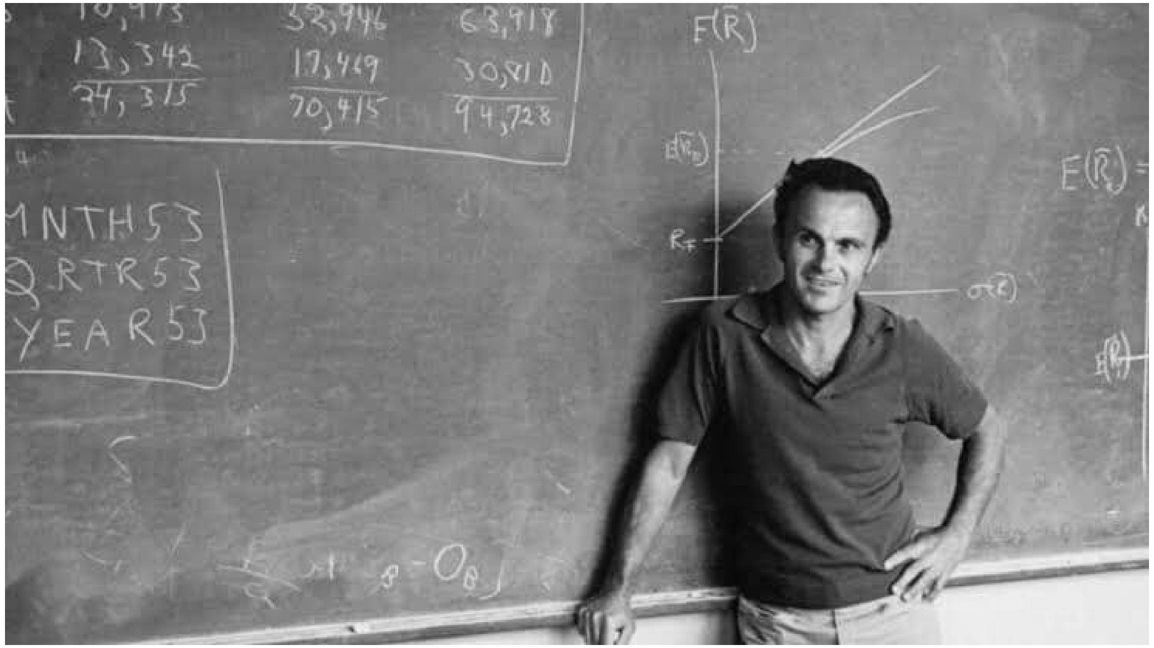
Source: Encyclopaedia Britannica, 'Harry Markowitz and modern portfolio theory', <https://www.britannica.com/money/consumer-staples-stocks >
Investopedia, CAPM, <https://www.investopedia.com/terms/c/capm.asp>

The Efficient Market Hypothesis explains how markets (are supposed to) work

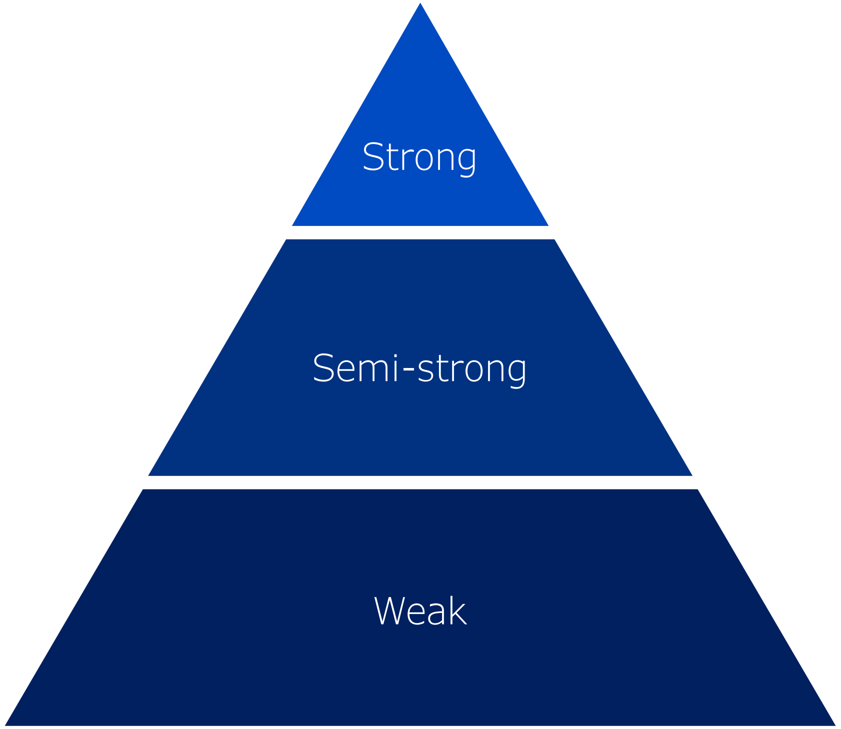
“Eugene F. Fama defined a market to be “informationally efficient” if prices at each **moment incorporate all available information about future values.**

- *Informational efficiency is a natural consequence of competition, relatively free entry, and low costs of information.*
- *If there is a signal, not incorporated in market prices, that future values will be high, competitive traders will buy on that signal.*
- *In doing so, they bid the price up, until it fully reflects the information in the signal.”*

Source: Cochrane, J. "Eugene F. Fama, efficient markets, and the Nobel Prize." Chicago Booth Review (2013) <https://www.chicagobooth.edu/review/eugene-fama-efficient-markets-and-the-nobel-prize>



The Efficient Market Hypothesis has three forms: strong form, semi-strong form, and weak form



Efficient market hypothesis	Description
investors cannot make returns on investments that exceed normal market returns, regardless of information retrieved or research conducted.	The strong form of the efficient market hypothesis states that all information—both the information available to the public and any information not publicly known—is completely accounted for in current stock prices, and there is no type of information that can give an investor an advantage on the market.
only information that is not readily available to the public can help investors boost their returns to a performance level above that of the general market.	The semi-strong form efficiency theory follows the belief that because all information that is public is used in the calculation of a stock's current price, investors cannot utilize either technical or fundamental analysis to gain higher returns in the market
investors can research companies' financial statements to increase their chances of making higher-than-market-average profits.	The weak form suggests that today’s stock prices reflect all the data of past prices and that no form of technical analysis can be effectively utilized to aid investors in making trading decisions.

https://www.chicagobooth.edu/review/eugene-fama-efficient-markets-and-the-nobel-prize

Whilst certain funds are ‘passive’ funds that offer primarily diversification benefits, some funds seek active returns (co-called ‘alpha’)

Any investor seeking ‘alpha’ returns assumes that markets are not perfectly efficient, since otherwise this would be impossible.

A typical ETF-type investment vehicle is seeking ‘beta’ returns, the equivalent of the market index it is representing

There is a divide between such ‘skill’ based investing models and market return generating assets, which could be thought of as ‘riding the market’ versus ‘beating the market’

Generally, hedge fund type vehicles will be examples of alpha seeking funds, whereas index funds are simply providing an opportunity to benefit from market returns (and profit from the diversification benefit).

‘Jensen’s Alpha’:

Alpha = R(i) - (R(f) + B x (R(m) - R(f)))

Where:

•R(i) = the realized return of the portfolio or investment
•R(m) = the realized return of the appropriate market index
•R(f) = the risk-free rate of return for the time
•B = the beta of the investment portfolio related to the chosen market index

Core points:
Any investor seeking ‘alpha’ returns assumes that markets are not perfectly rational, since otherwise this would be impossible.
A typical ETF-type investment vehicle is seeking ‘beta’ returns, the equivalent of the market index it is representing

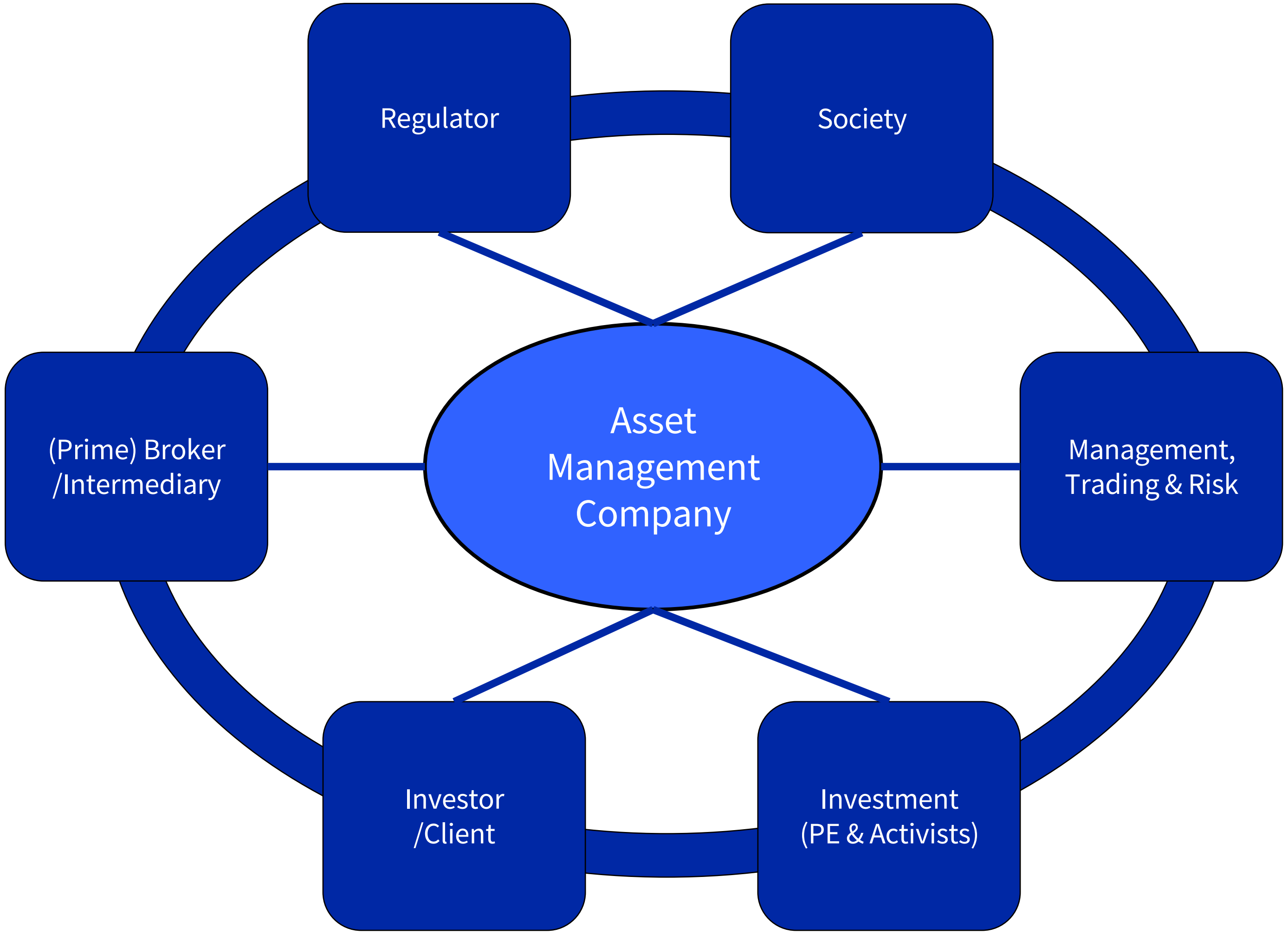
Source: Jensen, Michael C. "Risk, the pricing of capital assets, and the evaluation of investment portfolios." *The Journal of business* 42.2 (1969): 167-247.
Investopedia, ‘Jensen’s Alpha’, <https://www.investopedia.com/terms/j/jensensmeasure.asp>

The principal-agent problem and information asymmetry are not limited to corporate law in general, but appear in the context of investment funds as well

Agency theory defines an agency relationship to be a contract where one or more persons, referred to as the principal or principals, engage another person or group of people to take action on the behalf of the principal or principals by delegating some or all decision-making authority in a certain matter to the agent.[1]

- ➢Principal-Agent Problems
- ➢Contract (loose)
- ➢One or more persons (principal)
- ➢Engage another (agent)
- ➢Delegation of decision making authority

- ➢**Incentives Misaligned**
- ➢**Informational Asymmetry**
- ➢**Monitoring**



Source: Meckling, William H., and Michael C. Jensen. "Theory of the Firm." *Managerial behavior, agency costs and ownership structure* 3.4 (1976): 305-360.
Bruce Pollock, Alternative Investment Funds as Potential Catalysts in the Realization of Systemic Risk in Financial Markets: An Analysis of the Current Regulatory Framework in Europe Focusing on Hedge Funds and Private Equity Funds <https://www.dike.ch/pollock-alternative-investment-funds>

Regulatory rationale and the root causes for regulation

3

The are four main reasons why we would want to regulate investment funds

- Investor Protection
- Market Stability and Systemic Risk Prevention
- Internal Governance and Risk Management
- Transparency and Disclosure

The are four main reasons why we would want to regulate investment funds

Area of regulation	Challenges to solve
Investor Protection	conflict of interests, investor risks, informational asymmetries
Market Stability and Systemic Risk Prevention	macro risk and systemic stability
Internal Governance and Risk Management	systemic stability and investor protection
Transparency and Disclosure	asymmetrical information, lack of transparency vis-à-vis regulator

secondary, context-specific reasons for regulating investment funds

- Cross-Border Harmonization
- Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT)
- Market Integrity and Fair Competition

secondary, context-specific reasons for regulating investment funds

Area of regulation	Challenge to solve
Cross-Border Harmonization	regulatory arbitrage, market place competitiveness
Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT)	transparent fund flows, ultimate beneficial owners
Market Integrity and Fair Competition	pricing, information dissemination

In detail – regulatory needs

#	Root Cause	Risk Created	Who Is Affected	Regulatory Need
1	**Information asymmetry** between investors and fund managers	Poor investment decisions, mis-selling, hidden risks	Retail and institutional investors, regulators	Disclosure requirements, transparency standards
2	**Agency conflicts** between fund managers and investors	Self-serving decisions, excess risk-taking, underperformance	All investors, fund governance bodies	Conduct rules, governance frameworks, alignment mechanisms
3	**Cognitive/behavioral biases** among investors	Herding, panic selling, return-chasing, irrational decisions	Retail investors (primarily), markets as a whole	Product governance, investor protection rules
4	**Moral hazard** due to limited liability of fund managers	Reckless risk-taking, neglect of downside scenarios	Investors, counterparties, financial stability	Risk constraints, oversight, accountability mechanisms
5	**Market externalities** from collective fund behavior	Procyclicality, asset fire sales, systemic contagion	Other funds, financial institutions, economy at large	Systemic risk monitoring, macroprudential tools
6	**Liquidity transformation** in open-ended fund structures	Inability to meet redemptions, dilution of remaining investors	Investors (redeemers and non-redeemers), market participants	Liquidity rules, redemption restrictions
7	**Leverage** (explicit or embedded)	Amplified losses, fund blow-ups, counterparty risk	Investors, financial markets, systemically important institutions	Leverage limits, reporting, risk controls
8	**Valuation uncertainty or discretion**	Mispriced shares, unfair treatment of entering/exiting investors	Investors, auditors, supervisors	Valuation standards, third-party pricing
9	**Operational complexity and opacity** (incl. delegation chains)	Hidden risks, inadequate oversight, failure of outsourced services	Fund managers, regulators, investors	Operational risk standards, delegation oversight
10	**Fraud and misappropriation risk**	Direct loss of investor capital, reputational damage	Investors, fund boards, markets	Custody rules, audits, segregation of assets
11	**Misalignment of redemption terms and asset liquidity**	Run dynamics, forced asset sales, market disruption	Investors, market participants, regulators	Redemption gating tools, swing pricing, stress testing
12	**Illicit financial flows through funds**	Money laundering, terrorist financing, legal risk	Society, investors, law enforcement	AML/CFT frameworks, KYC, transaction monitoring

Comparative analysis of regulatory solutions across jurisdictions (CH/EU)

4

Europe has a catch-all approach, where there is a division between UCITS and non-UCITS (e.g. AIFMD, ELTIF, EuSEF etc.) funds

Criteria	UCITS	AIFs
Regulation	UCITS Directive	AIFM Directive
Asset Types	Listed stocks, listed bonds	Unlisted shares, real estate, infrastructure, artwork, commodities, forests
Accessibility	General public	Often reserved for sophisticated investors
Liquidity	High (daily valuation)	Lower (quarterly or annual valuation)
Investment Strategies	Standardized and diversified	Often more specialized and complex
Target Audience	All types of investors	Institutional and sophisticated investors

Bruce Pollock, Alternative Investment Funds as Potential Catalysts in the Realization of Systemic Risk in Financial Markets: An Analysis of the Current Regulatory Framework in Europe Focusing on Hedge Funds and Private Equity Funds <https://www.dike.ch/pollock-alternative-investment-funds>

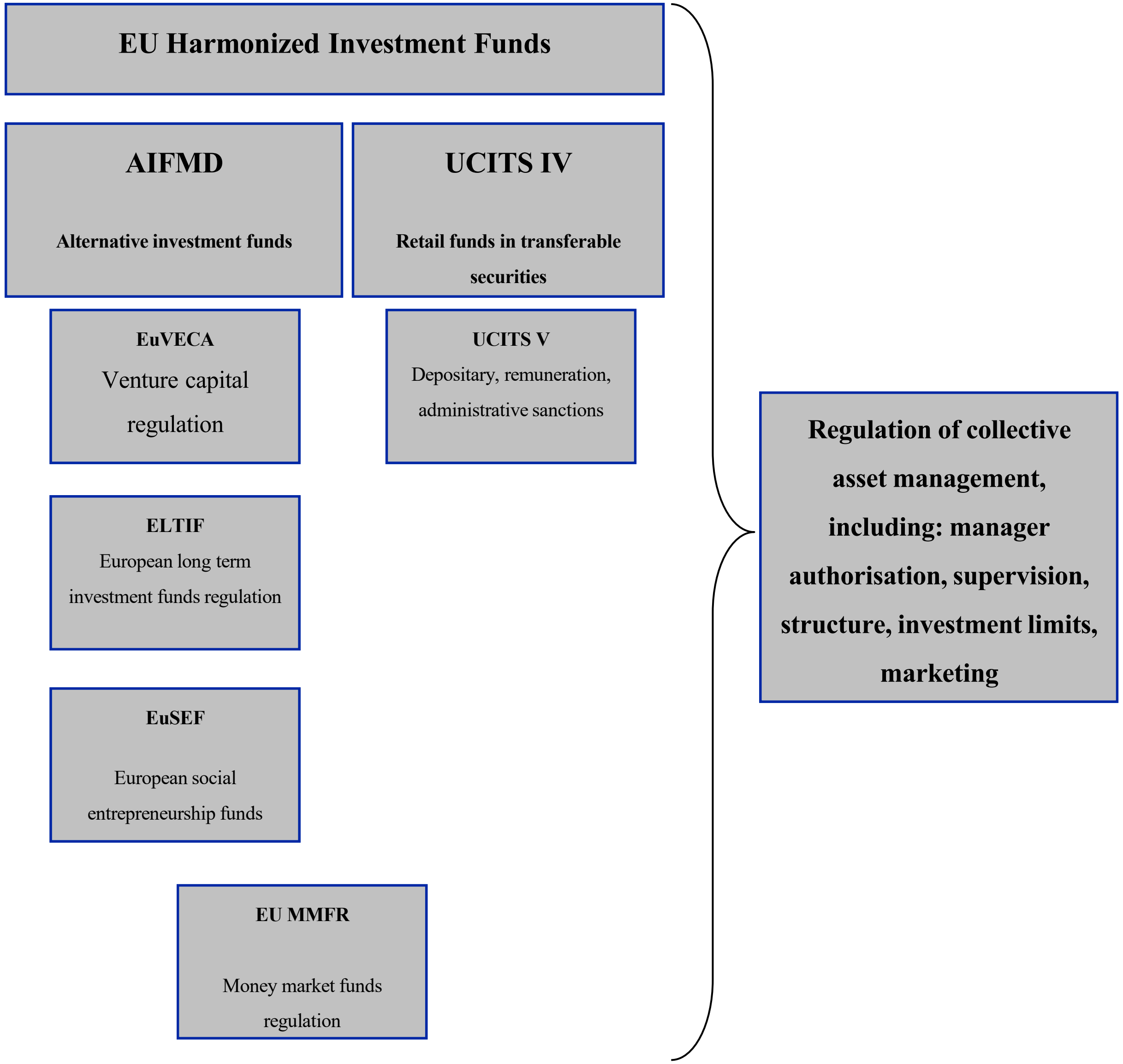
Examining the European regulatory landscape in detail shows us a different approach to fund regulation

Directives addressing different fund 'flavors':

- AIFMD
- UCITS
- EuVECA
- ELTIF
- EuSEF
- EU MMR

Regulation of collective asset management, including:

- ✓ manager authorisation,
- ✓ supervision,
- ✓ structure,
- ✓ investment limits,
- ✓ marketing



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Fund regulation is a fairly dynamic field with continuous revisions and amendments to existing directives and regulations

UCITS I	UCITS II	UCITS III	UCITS IV	UCITS V	UCITS VI
1985	**Abandoned (1998)**	**2001**	**2009** (in force)	**2014** (amends UCITS IV, in force)	**To be determined** (Proposal from [illegible]12)
• Original UCITS directive • European market for open-ended funds • Funds marketable and sellable to the public	• UCITS II proposal abandoned. • EU member states failed to reach an agreement on the directive's scope and purpose. • Provisions included many elements of the later UCITS III directive	• UCITS III was split into two parts, the **management directive** and **product directive** • Expansion of eligible assets	• Streamlining of regulator-to-regulator notification procedures • Management company passport • Key investor information document replacing simplified prospectus	• Depositary regime • Remuneration policies • Sanctions regime • Whistle-blowing procedure	• Eligib[illegible]ssets and [illegible] of deri[illegible]es • Eff[illegible]nt portfolio m[illegible]gement t[illegible]iques • [illegible]er the counter [illegible]TC) [illegible]erivatives • [illegible]xtraordinary liquidity

‘Omnibus’ directive (‘AIFMD II’)
Directive (EU) 2024/927

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1985	Abandoned	2001	2009	2014	To be ...ermined ...roposal ...m 2012)
• Original UCITS directive • European market for open-ended funds • Funds marketable and sellable to the public	• UC... ab... • EU... fai... ag... dir... an... • Pr... inc... ele... later UCITS III directive				• ...gible assets ...l use of ...ivatives • ...cient portfolio ...nagement ...nniques • ...er the counter ...TC) ...ivatives • Extraordinary liquidity

2025 (transposal by 2026):

The main changes made to AIFMD and transposed to the UCITS Directive include:

- The improvement of the availability and use of liquidity management tools
- The improvement of AIFMD regulatory reporting and the introduction of equivalent reporting for UCITS
- Information provided to authorities about asset managers' delegated activities. The delegation framework under AIFMD remains largely unchanged but it is specified that an AIMF must notify the national competent authority (NCA) of the intra and extra EU delegation of any of the functions listed in the Directive. In particular, the portfolio management or risk management delegation. Asset managers must also control delegated activities.

Source:
BNP Paribas: UCITS VI, <https://securities.cib.bnpparibas/ucits-directive-eu-regulation/>
Bruce Pollock, Alternative Investment Funds as Potential Catalysts in the Realization of Systemic Risk in Financial Markets: An Analysis of the Current Regulatory Framework in Europe Focusing on Hedge Funds and Private Equity Funds <https://www.dike.ch/pollock-alternative-investment-funds>

In Switzerland, fund regulation follows trends in EU

Federal Law on Investment Funds	Partial Revision of Federal Law on Investment Funds	Total revision / Collective Investment Schemes Act (CISA)	Partial revision of CISA	Partial revision of CISA	Partial revision of CISA
1966	1992	2005	2012	2020	2024
• Disclosure requirements • Segregation rules	• Alignment to UCITS Directive • Increasing investor protection through transparency	• Alignment to UCITS Directive • Introduction of new legal forms (SICAV, SICAF, LP)	• Alignment to MiFID • Increase investor protection through more transparency	• Amendments in connection with introduction of new financial market regulation in Switzerland (FinSA, FinIA, FMIA)	• Introduction of L-QIF as «unregulated» fund (no licensing requirement

Regulatory solutions (1)

#	Root Cause	Regulatory Need	CH	EU
1	**Information asymmetry** between investors and fund managers	Disclosure requirements, transparency standards	Person managing funds has duty to provide information on funds, assets of funds and fees, costs and compensation (art. 20 CISA) Prospectus requirements (art. 48 et seqq. CISA)	**UCITS:** Prospectus (Art. 68) and Key Investor Information Document (KIID) requirements (Art. 78). **AIFMD:** Duty to provide detailed pre-investment disclosures to investors (Art. 23).
2	**Agency conflicts** between fund managers and investors	Conduct rules, governance frameworks, alignment mechanisms	Person managing funds has duty of loyalty and duty to act diligently (art. 20 CISA). Person managing funds may only receive fees specified in relevant fund documents (art. 21 CISA)	**UCITS:** Duty to act honestly and fairly in the best interest of the UCITS; rules on conflicts of interest and remuneration (Art. 14, 14a/b). **AIFMD:** Duty to act in the best interest of the AIF; rules on conflicts of interest (Art. 14) and remuneration (Art. 13).
3	**Cognitive/behavioral biases** among investors	Product governance, investor protection rules	Fund management companies, collective asset managers, and funds (product) subject to licensing requirements by FINMA. Person managing investments must pursue investment policy that corresponds with investment characteristics of funds (art. 21 CISA)	**UCITS:** UCITS (product) subject to authorisation by competent authority (Art. 5). Strict, harmonised investment and diversification rules (Art. 50-57). **AIFMD:** Authorisation (defined strategy) & independent risk management function (Art. 6-8, 15).
4	**Moral hazard** due to limited liability of fund managers	Risk constraints, oversight, accountability mechanisms	Any person who breaches duties is liable for the losses resulting therefrom (art. 145 CISA). Criminal offense for certain behaviour (e.g. establishing of fund without license)(art. 148 CISA)	**UCITS:** Strict liability of the depositary for loss of financial instruments (Art. 24). Mandatory risk management process (Art. 51). **AIFMD:** Strict liability of the depositary for loss of financial instruments (Art. 21). Own funds/PII requirements to cover professional liability (Art. 9).
5	**Market externalities** from collective fund behavior	Systemic risk monitoring, macroprudential tools	FINMA: Data collection (focus on liquidity and leverage), stress test, monitoring of regulatory compliance. SNB: overall monitoring of systemic risks	**UCITS:** Calculation and monitoring of global exposure and leverage (Art. 51). Information sharing between authorities (Art. 101). **AIFMD:** Mandatory, detailed reporting to authorities on leverage, exposures, and liquidity for systemic risk monitoring (Art. 24).

Regulatory solutions (2)

#	Root Cause	Regulatory Need	CH	EU
6	**Liquidity transformation** in open-ended fund structures	Liquidity rules, redemption restrictions	**Liquidity**: Person managing funds must ensure that liquidity of funds are appropriate to investments, investment policy and risk diversification (liquidity management; art. 78a CISA) **Redemption**: Generally right to redemption at any time, except in certain cases set out in CISO (e.g. value difficult to ascertain, FINMA approval in extraordinary circumstances if provided for in fund documents.	**UCITS:** Must allow redemptions on demand (Art. 84). Must have an appropriate liquidity risk management policy; suspensions only in exceptional cases (Art. 51, 84). **AIFMD:** Must have a liquidity management system appropriate to the AIF's strategy (Art. 16). Redemption policy must be disclosed and coherent with liquidity profile (Art. 23).
7	**Leverage** (explicit or embedded)	Leverage limits, reporting, risk controls	Leverage rules set out in CISA/CISO depending on fund types (e.g. for open ended securities funds, 10% of net assets may be borrowed temporarily (art. 77 CISO).	**UCITS:** Global exposure is limited (e.g., 100% of NAV under commitment approach) and must be calculated and monitored (Art. 51). **AIFMD:** AIFM must set maximum leverage levels (Art. 15). Must report detailed leverage information to competent authorities for systemic risk monitoring (Art. 24).
8	**Valuation uncertainty or discretion**	Valuation standards, third-party pricing	If listed, valuation to market standards. If no current price available (e.g. non-listed funds, valuation by price probably obtained in a diligent sale (art. 88 CISA).	**UCITS:** Fund rules must specify valuation procedures. Depositary has oversight duty to ensure assets are valued properly (Art. 22, 85). **AIFMD:** AIFM is responsible for ensuring proper, independent, and fair valuation of AIF assets, either via an external valuer or an independent internal function (Art. 19).
9	**Operational complexity and opacity** (incl. delegation chains)	Operational risk standards, delegation oversight	Delegation of tasks only to third parties with necessary skills, knowledge and experience and required authorisation. Duty to instruct and supervise. Overall responsibility remains with person managing funds. (art. 14 FinIA)	**UCITS:** Management company may delegate functions but must not become a "letter-box" entity and remains fully responsible. Requires due diligence and supervision (Art. 13). **AIFMD:** AIFM may delegate functions, subject to strict conditions (e.g., objective reasons, no "letter-box" entity). AIFM remains fully responsible (Art. 20).

Regulatory solutions (3)

#	Root Cause	Regulatory Need	CH	EU
10	**Fraud and misappropriation risk**	Custody rules, audits, segregation of assets	Custodian Bank is responsible for safekeeping of investment fund's assets, issue and redemption of units. Custodian Bank ensures person managing fund complies with laws and regulations (art. 73 CISA)	**UCITS:** Requires a single depositary responsible for safekeeping of assets, cash flow monitoring, and oversight duties (Art. 22). **AIFMD:** Requires a single depositary responsible for safekeeping, cash monitoring, and oversight. Strict asset segregation rules and depositary liability (Art. 21).
11	**Misalignment of redemption terms and asset liquidity**	Redemption gating tools, swing pricing, stress testing	**Gating**: Pro rata cutting off of redemption application) on reaching percentage or threshold only allowed if in interest of remaining investors. Details must be disclosed in fund documents (art. 109 CISO). **Swing Pricing**: Adjusting NAV of fund by predefined percentage depending on inflows and outflows to treat investors equally and prevent dilution must be disclosed in fund documents. **Stress Testing**: Persons managing funds must carry out appropriate stress tests at regular intervals (art. 108a CISO):	**UCITS:** Must employ a liquidity risk management policy, including stress tests (Art. 51). Must select at least one appropriate liquidity management tool (LMT) (e.g., swing pricing, gates) from a harmonised list (Art. 84). **AIFMD:** Must have a liquidity management system and conduct stress tests (Art. 16). For open-ended AIFs, must select at least two appropriate LMTs from a harmonised list (Art. 16).
12	**Illicit financial flows through funds**	AML/CFT frameworks, KYC, transaction monitoring	Persons managing funds are subject to Swiss AML-regulation (art. 2 AMLA)	**UCITS:** Management companies are "obliged entities" subject to EU Anti-Money Laundering Directives (e.g., AMLD5/6), requiring full compliance with AML/CFT and KYC rules. **AIFMD:** AIFMs are "obliged entities" subject to EU Anti-Money Laundering Directives (e.g., AMLD5/6), requiring full compliance with AML/CFT and KYC rules.

Funds vs Companies

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Many of the regulatory needs discussed for funds also relevant for companies

Funds	Companies
Principal-Agent problem between investors and persons managing funds	Principal-Agent problem between shareholders and management
Liquidity rules	Capital rules
Information asymmetries between investors and persons managing funds	Information asymmetries between shareholders and management
Risk of illicit financial flows through funds	Risk of illicit financial flows through companies

Why regulate separately and not rely on existing corporate law rules?

Corporate law does apply to funds too

- Funds may be set-up as company
  - In Switzerland: SICAVs
    - Incorporation based on same rules that apply for companies limited by shares.
    - SICAV issues shares, has shareholders, board of directors and auditors.
    - Shareholders have same inspection rights as companies limited by shares.
    - GAFI notification requirements apply too.
  - For LPs and SICAFs, Swiss Code of Obligations applies where CISA does not provide special provisions.
  - Tendency by courts and supervisory authorities to treat funds as sub-form of corporations, for example in the US.

But…

Purpose and structural differences require separate regulatory regimes

Funds	Differences	Companies
Financial product	**Purpose**	Collective undertaking to pursue common objective
Flexible (redemption at any time)	**“Capital” Structure**	Fixed (share capital locked in)
Third-party governance / no direct control of investors	**Governance**	Shareholders have direct control

! However, evolution of use of funds and companies have blended these differences (e.g. closed-ended funds, companies used only for investment purposes) – thus, differences have become less pronounced.

Conclusion

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You should know that:

1. Funds are **pooled assets for collective investment** managed by a **third-party** (not investors themselves).
2. **Economic rationale** for funds is to take advantage of diversification and optimized portfolio structures, expertise of professional asset managers, and give investors access to investment products tailored to their risk preferences.
3. For funds to fulfil their economic purpose, **regulation is necessary**.
4. Fund regulation is **separate from corporate law** although similar issues are concerned.
5. Reasons for separated fund regulation lie in **nature and structure of funds** but evolution of how funds and companies are being set-up and used **have made differences less pronounced**.

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