Private equity in Switzerland: the suitability of the Limited Partnership for Collective Investment

Private equity (PE) investments present a number of specific characteristics that in turn correspond to particular regulatory needs. First, contrary to securities funds, which focus on stock market prices, and unlike hedge funds, where trading, leveraging, hedging, and arbitrage play key roles, PE involves active investments in target (or portfolio) companies. As regards venture capital, rather than purchasing securities, resources flow directly into the portfolio companies. Likewise, buyout funds focus on companies as the acquisitions they undertake comprise, among others, corporate financing, optimization of management and cost structure, and streamlining of operations. Second, as opposed, in general, to securities and hedge funds, PE investments tend to be illiquid, in that they frequently require a certain amount of time to implement the restructuring measures in the portfolio companies aimed at improving their valuation factors. As a result, this type of investments necessitates investors with a long-term horizon. Third, PE investments must not be subject to diversification requirements. These could oblige the vehicle to abandon profitable investments too early. Fourth, the success of PE investments hinges on the possibility to actively participate in the decision-making process in the portfolio companies. Thus, it is generally indispensable that PE fund managers join the board of directors of the portfolio company enabling them to shape the budget and business plan as well as optimization measures they consider appropriate. Fifth, PE investments need fiscal transparency given that value appreciation is subject to twofold taxation, namely, at the level of the portfolio company and at that of the investors. In particular, fiscal transparency needs to (a) exclude additional taxation at the level of the investment vehicle and (b) enable disbursements without the retention of withholding taxes at the level of the portfolio company. It is important to note that even refundable withholding taxes represent a significant disadvantage because they entail additional administrative efforts and costs, as well as delay in liquidity. Sixth, PE managers need to ensure confidentiality as to the structure of the investment vehicle, especially as regards investment term, compensation for the management, fiscal structuring, investments objectives, and corporate governance. Seventh, as a rule, PE necessitates rapid investments. In fact, often the first investment in a particular project is a key marketing factor to attract additional investors. Conversely, obstacles to promptly implementing an investment can entirely erode an opportunity.By creating the Limited Partnership for Collective Investment (LPCI) under the 2006 Collective Investment Schemes Act (CISA), the Swiss legislator explicitly intended to render the Alpine country more attractive for PE investors. Modelled after the Anglo-Saxon limited partnership and based upon a partnership agreement, the LPCI is set up with at least one general partner bearing unlimited liability, as well as one or more limited partners. The general partner must be a company limited by shares with its registered office in Switzerland. It may only fulfil this function for one LPCI. The limited partners need to be qualified investors as defined under the CISA. The LPCI is a closed-ended structure with a fixed capital base. Pursuant to the Collective Investment Schemes Ordinance (CISO), the partnership agreement requires the approval on the part of the Swiss Financial Market Supervisory Authority (FINMA).A number of legal provisions seem to satisfy the requirements outlined above. Under the CISO, the LPCI may invest in “risk capital”, a term used as a synonym for PE. Furthermore, given its closed-end structure and the restriction to qualified investors, this type of company allows for illiquid and long-term investments. In addition, neither the CISA nor the CISO provide for any diversification requirements. What is more, the LPCI may take control of voting rights in companies and join the governing body that is responsible for ultimate management, supervision and control of its participations, so as to safeguard the interests of the limited partners.At the same time, however, the Swiss legislator has introduced several elements that are most likely to deter PE investments. Remarkably enough, the LPCI is prohibited from taking up entrepreneurial activities for the pursuit of commercial purposes. In fact, in practice, it is virtually impossible to distinguish between the (authorised) strategic control over a portfolio company and (unauthorised) operational activities. Besides, from a fiscal point of view, the LPCI is only transparent with respect to income tax, provided it owns no real estate. By contrast, the company is opaque as far as withholding tax, stamp duty, real estate gains tax, property transfer tax, and value added tax are concerned. In particular the withholding tax on dividends, interests and other revenues entails noteworthy drawbacks for foreign investors. Under most double taxation treaties, the basic amount of the withholding tax is at least 15 per cent. In the event of refunding, the investors benefit from the full liquidity only after a considerable delay. Moreover, the partnership agreement must be submitted to the Commercial Register and thus is publicly accessible, while the limited partners may inspect the company's business accounts at any time. Highly unusual by international standards, these stipulations severely compromise the protection of confidential business information, which is often key for PE investments. Finally, the authorisation by FINMA is a lengthy process. For contractual investment schemes, the Authority needs some 66 days to examine a request. Given its relative rarity and additional regulatory requirements, an LPCI may face far longer authorisation procedures. Additionally, at the moment of the submission of the request, it is entirely uncertain how long the process will take.Clearly, in its current form, the LPCI is of only limited usefulness for PE investments. Therefore it is hardly a surprise that, FINMA has authorised no more than 19 companies of this type to date. What is more, only some of these pursue typical PE purposes. In practice, the quasi-totality of PE investments continues to take place through Anglo-Saxon limited partnerships, as well as similar entities established under the laws of other jurisdictions, such as Luxembourg and Dubai. To sum up, if Switzerland intends to become a serious competitor for PE investments on an international scale, it needs to revise the rules pertaining to the LPCI.