ing facility in Switzerland][13] *[or a simplified prospectus or a prospectus as such term is defined in the Swiss Collective Investment Scheme Act]*,[14] and neither this [document] nor any other offering or marketing material relating to the [Notes] may be publicly distributed or otherwise made publicly available in Switzerland.

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Lessons Learned from the Financial Crisis (Part 2) – OTC Cash Equity Trades

Reference: CapLaw-2011-23

In the last edition of CapLaw (CapLaw 1/2011), we focused on securities lending transactions which have come under special scrutiny in the financial crisis. In this edition, we will address OTC cash equity trades. As OTC cash equity trades may be exposed to similar risks as securities lending transactions, investors in these financial instruments, to some extent, faced similar issues during the financial crisis. Our below comments relate specifically to the OTC Cash Equity Trades Default Protocol. The protocol has been published by the AFME on 22 September 2010 with the aim to add legal certainty in the event of a signatory becoming insolvent.

By Urs Pulver / Petra Ginter

1) Introduction

At the time of the collapse of Lehman Brothers International (Europe) (LBIE) a number of banks entered into OTC cash settled equity trades with LBIE, which were not entered into on, or under the rules of, a regulated market (RM), multilateral trading facil-

13 Optional. Only relevant where the debt securities are or will be listed abroad and the offering material is called listing prospectus.

14 Optional. The addition *«or the Swiss Collective Investment Scheme Act»* should only be added if the debt securities are such that they come close to structured products. It is advisable to seek legal advice in the specific case.

15 Optional. Only relevant if debt securities are such that they come close to or could potentially constitute structured products. As a different legal regime could apply, *e.g.*, the securities could potentially only be eligible to be offered to qualified investors within the meaning of the CISA, it is advisable to seek legal advice.

ity (MTF) or similar venue. Furthermore, whilst the banks had purportedly put in place terms of business with LBIE, it was not in all cases clear whose terms would prevail. It is fairly common for banks to send each other their standard forms, resulting in a so-called battle of forms. In addition, the OTC cash equity trades were not entered into under any master agreements.

In many cases, this resulted in the trades not being governed by express terms, other than as to size, security and price. The absence of express terms to deal with the LBIE default created considerable legal uncertainty with regard to unsettled OTC trades.

Against this background, it became clear that contractual arrangements between banks trading cash equities bilaterally needed to be improved.

2) OTC Cash Equity Trades Default Protocol

In September 2010, the Association for Financial Markets in Europe (AFME) published a contractually binding protocol (Default Protocol) that permits the termination and valuation of trades in the OTC cash markets upon the insolvency of a party that had signed up to the Default Protocol.

The Default Protocol is governed by English law with exclusive jurisdiction of the English courts. The purpose of the Default Protocol is to provide a standard set of close-out netting provisions which parties can adhere to, and which adhering parties may (but are not obliged to) apply upon the default of another adhering party. The Default Protocol covers OTC cash equity trades that are not otherwise governed by the default rules of a RM, MTF or similar venue, or which are not covered by existing contractual terms between the parties governing the default (Covered Trades). It is designed for principal-to-principal trades and will not cover agency trades between buy-side and sell-side firms.

Upon default, all Covered Trades will be valued by the non defaulting party and close-out netting will be effected between the defaulting and non defaulting party. Performance of the Covered Trades will be replaced by the obligation on the party with the lower claim to pay the net amount. The close-out netting mechanism is derived from the Global Master Repurchase Agreement (GMRA) and the 2009/2010 GMSLA (as described in our article on securities lending in CapLaw 1/2011).

The initial scope of the Default Protocol is for it to apply among larger broker/dealers located in a relatively small number of European jurisdictions, including UK, Germany, France and Switzerland. The adherence mechanism is the same as for the Set-Off Protocol (as defined and described in our article on securities lending in CapLaw 1/2011).

3) Particularities with respect to a Swiss Adhering Party

The Default Protocol specifies that, *inter alia,* the liquidation procedures and protective measures applicable to Swiss banks and securities dealers (under Swiss law) qualify as Act of Insolvency. A default notice shall be deemed to have been served, even if no default notice is given, in the event of the *bankruptcy* of a Swiss bank or securities dealer, and the termination shall take effect as of the time immediately preceding the opening of bankruptcy (Automatic Early Termination; AET). With AET default market values will be determined as at the termination date, being the time of the opening of bankruptcy. These provisions improve the enforceability of the Default Protocol from a Swiss law perspective.

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U.S. Securities and Exchange Commission Issues Final Rules Implementing the Dodd-Frank Whistleblower Provisions

Reference: CapLaw-2011-24

The U.S. Securities and Exchange Commission recently approved the final rules implementing the whistleblower provisions of the Dodd-Frank Act. These rules provide significant financial incentives for whistleblowers to report violations of U.S. federal securities laws directly to the SEC. The new SEC whistleblower rules will apply not only to domestic U.S. public companies but also to foreign private issuers.

By Thomas Werlen / Stefan Sulzer

On 25 May 2011, the U.S. Securities and Exchange Commission (SEC) approved final rules (new Regulation 21F under the Securities Exchange Act of 1934 (Exchange Act)) implementing the whistleblower program mandated by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Act (Dodd-Frank Act). The new rules will become effective on 12 August 2011 (the final rulemaking release, SEC Release No. 34-64545 is available at http://www.sec.gov/rules/final/2011/34-64545.pdf).

While the Sarbanes-Oxley Act (SOX) encouraged *up the ladder* reporting by employees and allowed for self-policing and self-reporting by companies of potential violations, the new SEC whistleblower rules will incentivize external reporting to the regulators. The SEC has established a new Whistleblower Office in the Division of Enforcement and has fully funded its USD 450 million Investor Protection Fund to begin paying whistleblowers.