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SIX Swiss Exchange—New Rule Book for Participants and Traders

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Following the repatriation of its Blue Chip trading platform in May 2009 from London to Zurich SIX Swiss Exchange completely revised its general conditions for participants and traders. The new Rule Book entered into force on 1 April 2010 and replaced the General Conditions and the Transitional Rule Book for Blue Chip Trading as well as all related directives. Pending the entry into force of new rules on trade reporting of SIX Swiss Exchange in its capacity as Reporting Office presumably later in 2010 this article offers a first short introduction to the new rules applicable for participants and traders of SIX Swiss Exchange.

By Till Spillmann

1) New Rule Book—Background

On 1 April 2010 the new Rule Book of SIX Swiss Exchange entered into force (see http://www.six-exchange-regulation.com/regulation/participants_en.html). The new Rule Book sets out the admission criteria of securities traders to SIX Swiss Exchange and governs the organisation of trading as well as the rights and obligations of participants and their traders. These rules are based on the self-regulation concept set out in the Stock Exchange Act (SESTA) and have been approved by the Swiss Financial Market Supervisory Authority (FINMA). The reason for the overhaul of the provisions was twofold: First, the repatriation of Blue Chip trading from London to Zurich in May 2009 made a consolidation of the former Rules of SWX Europe (reflected in the Transitional Rule Book for Blue Chip Trading) and the General Conditions of SIX Swiss Exchange inevitable. Second, the General Conditions for SIX Swiss Exchange participants and the related directives have been continually amended in recent years to meet new requirements, which has made them less clear and harder to read. The revision replaced both documents with a single set of rules aligned with current national and international requirements and standards as of 1 April 2010.

The overriding principle when drafting the new rules was to change the existing rules as little as possible and as much as necessary in order to (i) consolidate existing transitional rules applicable for Blue Chip Trading (former Rules of SWX Europe) and the other trading segments of SIX Swiss Exchange (former General Conditions), (ii) formally revise the rules to enhance structure and readability; and (iii) align the rules with international standards where this was deemed to be expedient. Therefore, the intention of the overhaul of the rules applicable to participants and traders was mainly a formal revision of existing rules. However, the rules have—with regard to certain topics—been changed in substance as well.

This article offers a short overview of the content and structure of the new rules laid down in the Rule Book and its implementing directives as well as a first introduction to the Rule Book along with a selection of the most important changes to the rules and regulations.

2) Content and Structure of the New Rule Book

The new Rule Book governs the relationship between SIX Swiss Exchange and its participants as well as the participants' traders (as opposed to the Listing Rules and implementing directives which set out the rules for SIX Swiss Exchange's issuers).

The Rule Book consists of the following five parts:

- *Part I (Admission)* which governs the admission to participate in trading on SIX Swiss Exchange, the rights, obligations and exclusion of participants, as well as the suspension and termination of participation;
- *Part II (Trading)* which governs the organisation of trading on SIX Swiss Exchange;
- *Part III (Clearing and Settlement)* which sets out the rules with regard to clearing and settlement of trades on SIX Swiss Exchange;
- *Part IV (Monitoring and Enforcement)* which governs how Rule Book compliance is monitored, as well as the sanctions that may be imposed in the event of violations; and
- *Part V (Final Provisions)* which governs miscellaneous matters such as confidentiality, how the Rule Book may be amended, applicable law, place of jurisdiction, and transitional provisions.

The provisions for the implementation of the Rule Book are laid down in directives which form an integral part of the Rule Book.

Similarly to the top level of the regulation the existing directives of the General Conditions and the Transitional Rule Book for Blue Chip Trading have been consolidated, reduced in number (from originally more than 20 directives to 7) and complexity and are now structured as follows:

- Directive 1: Admission of Participants;
- Directive 2: Technical Connectivity;
- Directive 3: Trading;
- Directive 4: Market Control;
- Directive 5: Swiss Block;

– Directive 6: Market Information; and
– Directive 7: Fees and Costs.

General explanations and technical instructions with regard to participants' connection to the exchange system, as well as the organisation of on-exchange trading, are still laid down in (non-binding) Guides.

Participants submit themselves to the Rule Book by entering into a participation agreement of which the Rule Book and its directives form an integral part. In addition, in connection with the registration process traders are required to acknowledge the rules and regulations of SIX Swiss Exchange (including in particular the trading rules and the sanction regime applicable to them).

3) Most Important Changes under the New Regime

a) Equity Capital No Longer an Admission Requirement

Under the former General Conditions of SIX Swiss Exchange, securities dealers were required to have an equity capital of at least CHF 10 million in order to become a SIX Swiss Exchange participant. Members of the former SWX Europe and the former Transitional Rule Book of Blue Chip Trading were, however, not obliged to have a minimum equity capital.

According to the new Rule Book SIX Swiss Exchange no longer requires the participants to have a minimum equity capital. However, minimum equity requirements may indirectly apply as SIX Swiss Exchange requires applicants, pursuant to section 3.1 Rule Book, to hold a securities dealer license from FINMA or, if the applicant is a foreign securities dealer, a remote member authorisation from FINMA. Such licenses and authorisation usually include minimum equity capital requirements—though they may be lower than those applicable to Swiss securities dealer according to SESTA and the respective implementing rules.

b) Collateral Deposit Not Necessarily Required

Other than under the former rules of SWX Europe and the Transitional Rule Book for Blue Chip Trading, the former rules of SIX Swiss Exchange required applicants to arrange for a collateral deposit as a means of limiting the counterparty risk that participants incur when dealing with each other, as well as to cover any outstanding monies payable to SIX Swiss Exchange.

According to section 3.3 Rule Book, SIX Swiss Exchange may (but does not necessarily have to) require participants to pay a collateral deposit, which is primarily used to secure outstanding financial obligations to SIX Swiss Exchange and, secondarily, to cover outstanding obligations to other participants. According to section 5 of Directive 1 on

the Admission of Participants SIX Swiss Exchange must decide on whether collateral is to be provided based on the relevant applicant's or creditworthiness and in compliance with the principle of equal treatment.

c) Revised Trader Examination

As opposed to the regime applicable under the former General Conditions of SIX Swiss Exchange, the former Rules of SWX Europe as well as the former Transitional Rule Book for Blue Chip Trading did not require traders to pass an exam in order to trade on the SWX Europe and in the Blue Chip Segment of SIX Swiss Exchange, respectively. Therefore, in connection with the revision the SIX Swiss Exchange trader examination has been overhauled as well and now consists of individual modules. Moreover, traders who have already passed an examination of a foreign stock exchange recognised by SIX Swiss Exchange may benefit from a simplified trader examination.

In addition, as of 1 April 2010, all traders registered with SIX Swiss Exchange will be required to take a web-based refresher course when major regulatory or technological changes are introduced, but at least every two years. Further details are set out in section 6 of Directive 1 on Admission of Participants.

d) On-exchange, On-order-book and Off-order-book Trades

According to the new Rule Book, SIX Swiss Exchange differentiates between on-order-book and off-order-book trading. Trades conducted via the order book are designated as "on-exchange, on-order-book trades", while trades made off-order-book that participants report to SIX Swiss Exchange in compliance with the Rule Book are designated as "on-exchange, off-order-book trades". In order for an off-order-book trade to be reported in accordance with the Rule Book, section 11 Rule Book requires that (i) the involved participants agree prior to or at the time of the trade that the trade should be made according to the provisions of the Rule Book; (ii) the trade is reported to SIX Swiss Exchange in accordance with the provisions of the Rule Book (in particular with respect to the content and deadlines); and (iii) the price of the reported trade passes a plausibility test of SIX Swiss Exchange. Directive 3 on Trading provides for further details. The new concept offers participants the possibility to execute trades off-order-book while, at the same time, such trades are still deemed to be executed on-exchange. These on-exchange, off-order-book trades benefit from the protection provided by the Rule Book such as, for instance, trading as well as clearing and settlement provisions (incl. the standard contract with buy-in rules) set out therein.

Off-order-book trades that are not reported to SIX Swiss Exchange but, for instance, to SIX Swiss Exchange in its capacity as Reporting Office or to a Trade Data Monitor (such as Boat) are designated as "off-exchange trades". Such trades are not subject to the provisions of the Rule Book.

e) Revised Rules on Reporting of Trades and Delayed Publication

For transactions in securities that have been admitted to trading on SIX Swiss Exchange, all securities dealers are obligated to report these trades to a reporting office officially recognised by SIX Swiss Exchange. Securities dealers report their trades directly to the Reporting Office of SIX Swiss Exchange (as already indicated in the outset, the rules of SIX Swiss Exchange in its capacity as the Reporting Office are expected to enter into force later in 2010). Foreign securities dealers may also report trades to a Trade Data Monitor (TDM) recognised by SIX Swiss Exchange.

Another innovation pertains to the trade reporting deadline: As of 1 April 2010, a shorter post-trading reporting deadline of *three minutes* will apply with respect to trades in shares, investment funds and exchange traded funds (this has already been the deadline in the Blue Chip Segment and on the former SWX Europe).

The MiFID aligned concept also includes a new regime for delayed publication of block trades. As further set out in Directive 3 on Trading the delayed publication function is applicable to off-order-book trades with regard to certain trading segments (as set out in the respective Annexes to Directive 3). SIX Swiss Exchange may publish trades with the necessary minimum volume depending on the average daily turnover with a delay if the transaction is conducted between a participant trading on its own account (nostro) and a client of this participant. The respective details are set out in Annex R to Directive 3.

f) Clearing and Settlement

With respect to clearing and settlement of trades, the new Rule Book retains the open offer-concept with respect to trades cleared and settled via a central counterparty and provides for new and more stringent buy-in rules for on-exchange, off-order-book trades.

4) Conclusion

The repatriation of the Blue Chip trading from London to Zurich, including the consolidation of the former Rules of SWX Europe and SIX Swiss Exchange, was a challenging task on the part of SIX Swiss Exchange from the business, the technical as well as the regulatory and legal perspective. A smooth transition process has been of vital interest for SIX Swiss Exchange and its participants and registered traders.

The complete overhaul of the rules and regulations pertaining to participants and traders aimed—in addition to the required consolidation of rules—to result in a shorter set of rules with a simpler structure that is also more reader-friendly. Whether this aim has been achieved remains to be seen in practice.

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Consultation of SIX Swiss Exchange regarding Amendment of Management Transactions Rules

Reference: CapLaw-2010-27

By Andrea Huber

Introduction: SIX Exchange Regulation has initiated a consultation process regarding proposed changes to SIX Listing Rules in management transactions.

Status Quo: Pursuant to article 56 SIX Listing Rules, the members of the board of directors and senior management of an issuer must report their transactions regarding shares of the issuer to the issuer no later than the second trading day after the transactions have been concluded. The issuer must then forward such notification as "single notification" to SIX Exchange Regulation within two trading days if the total value of all transactions concluded by the person in question exceeds the amount of CHF 100,000 within one calendar month. If the value of all transactions concluded by the person who is subject to the reporting obligation does not exceed the amount of CHF 100,000 within one calendar month, the issuer shall forward the notifications as "omnibus notifications" to SIX Exchange Regulation no later than four trading days following the end of the calendar month. Such "omnibus notifications" are not published by SIX Exchange Regulation.

Proposed Amendments to Article 56 SIX Listing Rules:

Elimination of the CHF 100,000 threshold: SIX Exchange Regulation proposes to eliminate the CHF 100,000 threshold to simplify issuer obligations. In consequence, all notifications irrespective of the amount will be published by SIX Exchange Regulation.

Publication of transaction notifications over a three-year period: Details regarding management transactions currently may be accessed on the SIX Exchange Regulation website for a period of one year. Such period shall be extended to three years based on needs of investors, scientists and market participants.

Disclosure of the identity of the bank or authorized securities dealer having executed the transaction: In connection with prevention of market abuse, disclosure of the identity of the bank or securities dealer having executed the transaction would not only help SIX Exchange Regulation to verify those management transactions which have been published but also enable it to cross-check data. Such data would not be accessible to the general public.

Directive on Disclosure of Management Transactions: Besides the amendments described above, SIX Exchange Regulation further seeks to make a number of

editorial adjustments to article 56 SIX Listing Rules. Adaptations would also have to be made to the Directive on Disclosure of Management Transactions.

Further steps: Issuers and market participants may send comments and other suggestions relating to the proposed changes to SIX Exchange Regulation via e-mail (vernehmlassung@six-group.com) by 17 Mai 2010 at the latest.

Andrea Huber (andrea.huber@nkf.ch)

Employee Options in Takeover Proceedings

Reference: CapLaw-2010-28

Bidders of a target company with outstanding employee stock options have to overcome a number of potential regulatory obstacles in order to gain full control of the target company and thus eliminating any contingent equity ownership conferred by stock options. This article sheds some light on how this objective can be achieved and highlights the regulatory issues involved.

By Thomas Reutter / Flavio Lardelli

1) Introduction

How to handle employee stock options of the target company is a question bidders in takeover proceedings are often faced with. In many cases, employee stock options are only dealt with as part of a "clean-up" exercise subsequent to the consummation of the public tender offer (PTO) for the shareholders of the target company. Nevertheless, given the relatively high potential for litigation and the usually complex framework of contractual, regulatory and tax provisions, bidders are well advised to explore possible solutions and firm up their intentions with respect to a target company's employee stock options as early as possible.

In many cases stock option plans include explicit rules for a change of control or even a public takeover bid scenario and sometimes provide for an accelerated vesting or exercise, voluntary or mandatory redemption or a roll-over into the stock option plan of the acquirer. Often, however, a bidder wishing to eliminate any future minority shareholder interest will be forced to make some kind of offer to holders of employee stock options, either directly or indirectly through the target company. The offer may relate to a purchase or repurchase of outstanding options against cash or against shares of the bidder or it may simply relate to a substitution of the shares underlying the options with shares of the bidder (roll-over). Any such offer must observe the constraints imposed by Swiss takeover law even if the offer itself does not constitute a PTO within the meaning of the Stock Exchange Act (SESTA). Alternatively or subsequent to any

offer to stock option holders, the bidder may petition to cancel all remaining outstanding stock options in accordance with article 33 SESTA.

2) Equal Treatment with Respect to Offer Consideration

The so called "Best Price Rule" ensures equal treatment with respect to the offer consideration or "price". It states that any bidder acquiring equity securities of the target company in the period running from publication of a PTO until six months after expiry of the supplementary acceptance period, at a price that exceeds the offer price in the PTO, must offer this (higher) price to all recipients of the offer (article 10 (1) of the Takeover Ordinance (TOO)). The Best Price Rule also applies to the acquisition of financial instruments such as stock options (article 10 (2) TOO). Thus, if a bidder pays a consideration to holders of employee stock options and breaches the Best Price Rule, it must pay a higher price to shareholders of the target company as well. But how can equity securities as different as shares and options be compared from a valuation perspective?

In its recent decision regarding Jelmoli Holding AG the Takeover Board (TOB) has not specifically addressed the issue, but seemed to imply that whenever a generally accepted option price valuation method is used, the Best Price Rule has been observed (see TOB decision in the matter of Jelmoli Holding AG dated 27 December 2009). According to the TOB, the Black-Scholes model and the binomial model are generally accepted valuation methods for options. The Black-Scholes model includes the five key determinants of the option's price as underlying stock price, strike price, volatility, time to expiration and short-term risk free interest rate (TOB decision in the matter of Berna Biotech AG dated 11 January 2006, 1.4.2.). For options that are "in the money", the Best Price Rule is also observed if the intrinsic value, *i.e.* the difference between the market price and the strike price, or a lesser value serves as the basis for the consideration offered. Interestingly, the TOB does not promulgate any specifics as to the pricing parameters used in the different stock option models. Nevertheless, it would seem that the parameter "market price of the underlying stock" cannot be higher than the value of the offer consideration in the PTO without breaching the Best Price Rule. In addition, it also seems fair to conclude that any valuation method that is not established and any pricing parameters that are not appropriate or justifiable may lead to a violation of the Best Price Rule.

In a recent transaction it has been suggested to use binomial valuation models that are more specifically designed to employee stock options such as the so called "Enhanced American Model" (EAM) developed by Ammann and Seiz (see Ammann/Seiz, An IFRS 2 and FASB 123 (R) compatible Model for the Valuation of Employee Stock Options, Swiss Society for Financial Market Research 2005, 381 ff.). The TOB did not comment on the merits of this method to find the "most adequate" price of employee stock options but merely stated that the model is permissible as long as the valuation leads

to lower results than the intrinsic value method (TOB decision in the matter of Jelmoli dated 28 December 2009, 1.1.). If options are to be exchanged into shares of the bidder pursuant to an offer made to option holders it is also required to value the shares offered as consideration. In this case, the relevant value of the shares is the opening price on the date of the consummation of the takeover offer (see TOB recommendation in the matter of Acorn Alternative Strategies AG dated 25 September 2006, 5.2.). As a result, the relevant share price to determine the number of shares owed to the holder of options cannot be lower than this opening price.

It is important to note that the Best Price Rule applies also to employee options which are or were not the object of the PTO for the target company's shares (TOB decision in the matter of Speedel dated 20 January 2009, 2.1.; TOB decision in the matter of Jelmoli dated 28 December 2009, 1.1.). Hence, the scope of application of the Best Price Rule to employee stock options is broad and subject only to very few exemptions. Exemptions were made, for example, for the acquisition of shares or the allotment of options within the scope of the completion of an employee stock option plan (TOB recommendation in the matter of Sarasin dated 16 February 2007, 6.5.2.).

3) Other Aspects of Equal Treatment

As per article 24 (2) SESTA the bidder has to treat all holders of equity securities of the same class equally. The principle of equal treatment also applies to financial instruments such as employee stock options to which a PTO relates (article 9 (2) TOO). Hence, the principle of equal treatment does not apply—subject to cases of abusive evasion—to equity securities or financial instruments to which a PTO does not relate (article 9 (2) TOO *e contrario*). This is often the case in practice given that Swiss law does not oblige a bidder to extend its PTO to unlisted equity securities or financial instruments (whether listed or unlisted) (article 9 (2) and 9 (4) TOO). In such cases, the bidder must nevertheless ensure that an equitable ratio is preserved between the prices offered for the various equity securities and financial instruments (article 9 (3) TOO).

In some other cases, however, financial instruments such as stock options are closely linked to a PTO and it seems justified to also extend the equal treatment principle in general—and not just the Best Price Rule as its most important feature—to these cases. The TOB has therefore held that the equal treatment principle applies in case of amendment or completion of the option plan in the context of a change of control related to a PTO (TOB recommendation in the matter of Serono dated 8 January 2007, 5.2.2.) and in case the option plan provides for early exercise of options in connection with a PTO (Decision FINMA in the matter of Sarasin Investmentfonds AG, Quadrant AG, et al., dated 8 July 2009, 16).

Given that equal treatment as to the level of the offer consideration is governed by the Best Price Rule (see above), the most important remaining aspect of the equal treatment principle is the nature of the offer consideration. Hence, a bidder may not differentiate as to the nature of the offer consideration if the equal treatment applies. This means, for example, that a bidder may not, absent a consent by the offeree, compensate holders of shares in cash and holders of stock options in shares in case the equal treatment principle applies. As a result of the above, a bidder who does not extend its cash PTO to the target's employee stock options keeps the flexibility to compensate these stock option holders in either cash or shares absent any of the exemptions mentioned above. The same applies to a share exchange PTO that is not extended to the target's employee stock options.

If, by contrast, the equal treatment principle applies, a bidder may not discriminate offerees as to the nature of the offer consideration: In case a bidder has consummated a share exchange PTO and offers a cash compensation to holders of employee stock options, it would in principle have to extend a cash alternative retroactively to all holders of shares in the target company (see TOB decision in the matter of Jelmoli dated 28 December 2009, 1.2.; communication no. 4 of the TOB dated 9 February 2009). It may be argued, however, that this obligation no longer arises if the cash consideration offered to holders of employee stock options is made after six months following the expiry of the additional acceptance period of the PTO.

4) Squeeze-out of Outstanding Employee Options

Bidders who upon expiry of the offer period hold, directly or indirectly, more than 98 percent of the voting rights of the target company may, within three months, petition the competent court to cancel the outstanding equity securities according to article 33 SESTA. Prior to the most recent amendment to the TOO, in force since 1 January 2009, stock options were specifically designated as equity securities and it was therefore clear that the cancellation procedure pursuant to article 33 SESTA would apply to stock options as well. However, it seems fair to assume that the change in terminology was not intended to carve stock options—now designated as financial instruments in the TOO—out of the scope of application of this procedure. This is confirmed by court decisions on a cantonal level (see *e.g.* Decision of the Civil Court of Basel-City in the matter of Novartis Pharma AG vs. Speedel Holding AG dated 13 August 2009, in: Swiss Official Gazette of Commerce (SOGC) No. 160 dated 20 August 2009, 40). Obviously, the cancellation procedure only applies (and need only apply) to stock options that may not be settled in cash without the consent of the holder (physically settled stock options).

In our view, article 33 SESTA applies even if the stock options petitioned to be cancelled have not been subject to the preceding PTO or an offer ancillary thereto. This view is supported by court decisions on a cantonal level (see Decision in the matter

of Speedel dated 20 January 2009, I. G. and the corresponding Decision of the Civil Court of Basel-City dated 13 August 2009). This is justified by the fact that a bidder cannot be expected to spend enormous sums on a takeover transaction without being able to obtain full control of the target. However, this may put holders of stock options at the risk of a compensation that is unfair. In contrast to the class of shareholders, there is no similar "implied fairness test" for stock option holders in the likely event that the bidder has not already acquired 98 percent of the stock options outstanding based on a voluntary offer. However, the expedited cancellation procedure is not designed to test the fairness of a compensation and courts have thus refrained from determining a compensation in such procedures. Holders of cancelled stock options would therefore have to sue the bidder in the competent civil courts for adequate compensation.

The cancellation procedure pursuant to article 33 SESTA is the only remedy available for bidders to overcome reluctant stock option holders and to obtain full control of the target company. A merger or squeeze-out merger pursuant to the Swiss Merger Act may help a bidder to obtain full control through a statutory merger against cash or shares, but is not amenable to a forced discontinuation of stock option ownership. However, as the underlying of the stock options disappears and may no longer be delivered upon exercise, a holder of stock options will have to accept either the shares of the surviving merger entity (rollover) or cash instead of the target's stock depending on the interpretation of the respective stock option plan.

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TOB Circular No. 1: New Regulation of Share Buy-back Transactions (UEK-Rundschreiben Nr. 1: Rückkaufprogramme)

Reference: CapLaw-2010-29

Following the proposal for a revision of Communication No. 1 dealing with share buy-backs, the Takeover Board issued the final version in the form of TOB Circular No. 1. The final text cures most shortcomings of the draft published by the Takeover Board. Among other things, the general exemption for buy-backs for up to 2% has been re-introduced and the proposed limitations on buy-backs of more than 10% of the share capital based on a conservative interpretation of corporate law have not been adopted. Together with the final version of Circular No. 1, the Takeover Board published a proposal for already the next revision of Circular No. 1.

*By Dieter Gericke**

1) Introduction

On 24 April 2009, the Takeover Board proposed a revision of Communication No. 1 (Comm 1), dealing with share buy-backs of Swiss companies listed at a Swiss stock exchange (see Dieter Gericke, Share Buy-back: Revision of Communication No. 1, CapLaw-2009-41). Following the completion of the commenting period on the draft text (DraftCirc 1), the Takeover Board issued *TOB Circular No. 1: Buy-back programmes*, dated 26 February 2010 (Circular 1). In addition, the Takeover Board published a proposal for a revision of Circular 1 that would replace the common buy-back programs by way of a second trading line by an auction procedure (see section 6 below).

Circular 1 replaces Comm 1 in its entirety and does not follow the wording and structure of Comm 1. Circular 1 will apply to all requests for exemption filed after 31 May 2010. As from 1 June 2010, paragraphs 12 and 33 of Circular 1 relating to the declaration of transactions will also apply with respect to buy-back programs in progress for which an exemption has been sought/granted before such date.

2) Legal Nature and Basis

Circular 1 belongs to the realm of informal lawmaking (see Dieter Gericke, Funktioniert der Rechtsstaat im Kapitalmarkt?, in: von der Crone/Forstmoser/Weber/Zäch (Hrsg.), Aktuelle Fragen des Bank- und Finanzmarktrechts, Festschrift für Dieter Zobl zum 60. Geburtstag, Zurich 2004, 359, 366). While the circular is not binding, it enjoys law-like effect and enforceability. It may therefore lead to conflicts with rule of law principles to the extent that its provisions do not root in formal laws and ordinances. As the provisions of Circular 1 are less expansive than those proposed in DraftCirc 1, the issue

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seems, however less prevalent (for more detailed discussions of the legal nature and basis of the regulation of share buy-backs in light of the principles of the rule of law see Peter Böckli, Schweizer Aktienrecht., 4th ed., Zurich/Basel/Genf 2009, N 273 ss.; Urs Gasser, Der Erwerb eigener Aktien—(K)ein Anwendungsfall des Börsengesellschaftsrechts?, AJP 1998, 663 ss.; Gericke, Share Buy-back, op.cit., 12 s.; Andreas von Planta/Jacques Iffland, Rachat d'actions de sociétés cotées—problèmes actuels et évolution de la pratique, in: Wirtschaftsrecht zu Beginn des 21. Jahrhunderts: Festschrift für Peter Nobel zum 60. Geburtstag, Berne 2005, 282 s.; see also the discussion of the compliance of select provisions of DraftCirc 1 with the division of powers and the rule of law in the comments to DraftCirc 1 (published on www.takeover.ch), in particular, the comments of SwissHoldings dated 8 June 2009, 3 s.; Walder Wyss & Partner dated 8 June 2009, 3 s.; Bader Natsch Gnehm dated 7 June 2009, 3; Homburger dated 5 June 2009, 4; Niederer Kraft & Frey dated 5 June 2009, 7; Lenz & Staehelin dated 5 June 2009, 6; von der Crone dated 5 June 2009, 2 and 6; Vischer dated 5 June 2009, 4; Schindler dated 7 June 2009, 3; as well as in Gericke, Share Buy-back, op.cit., 14, 15, 17).

From a substantive point of view, takeover rules were not meant to regulate share buy-backs (Gasser, op.cit., 670) and do not offer an adequate regulation of share buy-backs by listed companies (cf. Andreas von Planta/Jacques Iffland, Rachat d'actions de sociétés cotées, in FS Nobel zum 60. Geburtstag, Berne 2005, 285 s.). The relevant topics, such as market distortion and stock price manipulation as well as equal treatment of shareholders, are issues of general market regulation and corporate law and do not necessarily depend on the distinction between a private and a public share purchase (cf. Rudolf Tschäni/Jacques Iffland/Hans-Jakob Diem, Öffentliche Kaufangebote, 2nd ed., Zurich 2010, N 37).

3) Categories of Exemptions and Procedures and Their Requirements

a) 2%—Exemption

Like Comm 1, Circular 1 *generally exempts* buy-backs of up to 2% of the share capital and voting rights. In analogy to the reporting procedure (see Circular 1, para. 8), this threshold should be measured based on the issued shares as registered in the commercial register. In contrast to Comm 1, such exemption may only be used once in any fiscal year and the relevant program must be notified to the Takeover Board at the time of its announcement (Circular 1, para. 38). These new restrictions seem superfluous and, in particular the notification duty, may induce issuers not to openly announce buy-back programs up to 2% if avoidable. Such effect would not be in the interest of the market. Furthermore, issuers may become entangled in legal hair-splitting, for example on the question whether the announcement of an employee stock option plan that (also) provides for the possibility of the relevant shares being purchased over the market, qualifies as a public offer for share purchases.

b) Reporting Procedure (*Meldeverfahren*)

As was the case under Comm 1, the simplified reporting procedure applies, as a rule, if the buy-back program affects not more than *10% of the share capital* and the voting rights registered in the commercial register (Circular 1, para. 8). However, unlike Comm 1, Circular 1 (para. 6–10) reduces the scope of application of the reporting procedure by several *additional tests*:

– The volume of the program may not affect more than *20% of the free float* of the relevant securities on the day of filing. For such purposes, the free float must be calculated in accordance with the provisions of the relevant stock exchange (Circular 1, para. 9; see, for example, SIX Directive on the Distribution of Equity Securities, dated 29 October 2008). The legitimacy of the Takeover Board's concern about the liquidity of traded shares implied by this restriction seems questionable (see Gericke, Share Buy-back, op.cit., 17).

– While Comm 1 required that the buy-back does not lead to a delisting of the issuer's shares, Circular 1 dropped that more hypothetical scenario and still goes beyond it by restricting the reporting procedure to buy-backs that do not reduce the free float to below the level which is required for a listing under the rules of the relevant stock exchange. A number of listed companies were granted exemptions from those minimum free float requirements at the time of their listing or dropped below such level afterwards. It remains to be seen whether the Takeover Board will, also in such cases, apply the regular free float thresholds for the purposes of this requirement.

– The buy-back may not lead to a *material change of the control* exercised over the issuer. Circular 1 does not further specify this requirement. Arguably, the Takeover Board would not only view an actual change of the majority as a material change, but also changes of minority positions that are materially relevant either under corporate law (*e.g.* if a shareholder obtains a blocking minority position for 2/3 voting requirements) or under stock exchange law. The main question will, however, be whether such analysis may assume proportional sales into the buy-back program or needs to take into account all theoretically possible scenarios. In the past, the Takeover Board applied this requirement (only) in the regular exemption proceedings for share buy-backs exceeding 10% of the shares (see for example, TOB Order 435/02 regarding Transocean Ltd., dated 24 February 2010, consid. 1, para. 4). Usually, its analysis was partly based on the current situation and partly on the purpose of the buy-back and potential future scenarios. Given the latitude of discretion implied by this practice, this criterion may lack the tick-the-box nature that would be needed for an issuer to choose the right procedural path.

The filing for an exemption in the reporting procedure must be submitted five trading days prior to the planned publication of the repurchase notice with the relevant form. Amendments of the buy-back program, including its purpose, must be submitted in the same way.

c) Regular Exemption Proceeding

As before, if a buy-back program does not fall under the 2%-safe harbor and does not meet the requirements of the reporting procedure, an exemption from the takeover regulations must be sought based on the general rule of article 4 Takeover Ordinance. However, pursuant to Circular 1, para. 44, the Takeover Board will look at it as an exemption from Circular 1 rather than an exemption from the regular takeover regulations. Therefore, the issuer is not required to substantiate reasons for all deviations from the regular takeover regulations, but only the scope of, and reasons for, the deviation from the requirements and the provisions of Circular 1.

4) Provisions Governing Buy-backs Based on the Reporting Procedure

a) Principle of Equal Treatment

i. Scope of Buy-back Offer

As set out in article 9 (2) Takeover Ordinance, the buy-back must extend to all of the issuer's listed equity securities (Circular 1, para. 6). In case of buy-back programs over the stock exchange, the issuer must place simultaneous bids for all categories of listed equity securities (para. 28).

ii. Purchase of Shares outside the Buy-back Program

One of the most criticized provisions of DraftCirc 1 was the proposal to prohibit any purchase of shares outside the buy-back program, as this prohibition would have been too restrictive and without basis in formal law. Circular 1 takes this criticism partly into account by limiting the prohibition to purchases for the same purpose as the declared purpose of the buy-back program (para. 12). As a consequence, the purpose of share buy-backs will, in the future, need to be narrowly tailored, in order to avoid that too many legitimate purchases outside a buy-back program will be prohibited. While this limited prohibition of share purchases may prevent circumventions of the rules governing share buy-backs, such prohibition, which does not apply according to regular takeover regulations, lacks a sufficient legal basis and may therefore not be enforceable.

As a practical matter, the Takeover Board may not desire to actually prohibit purchases outside a buy-back program for the same purpose, but, under the principles of fairness and equal treatment, require the observation of the rules and limitations governing the buy-back program (see Gericke, Share Buy-back, op.cit., 14). Interpreted this way, the restriction may have a better justification.

iii. Relationship of Prices Offered

As set out in article 9 (3) Takeover Ordinance, the issuer must ensure an adequate relationship of the prices offered for different categories of shares (Circular 1, para. 11). This provision will mainly be of relevance in connection with a buy-back through a tender offer or the issuance of put options. In case of purchases over the stock exchange, as a rule, the market price and the 5% limitation on a premium over the market price (see subsection iv below) ensures such adequate relationship.

iv. Best Price Rule/Maximum Price

The best price rule in the form set out in article 10 Takeover Ordinance only applies in connection with buy-backs through a tender offer or through the issuance of put options (Circular 1, para. 21). With regard to buy-back programs on a separate trading line, the issuer may freely set the price paid within the program, as long as it does not on the separate trading line offer a premium of more than 5% over the last price paid or offered on the regular trading line (para. 32). While a violation of this provision must be reported to the Takeover Board, the sanctions of such violation are unclear. For off-exchange block trades in connection with a buy-back over the stock exchange, the price paid for a block may not exceed the last price paid or offered on the stock exchange by an independent third party (para. 30).

b) Special Provisions for Buy-backs Over the Stock Exchange

i. Share Purchases during Black-out Periods (DraftCirc 1, para. 27 ss.)

Comm 1 demanded share buy-backs to be interrupted during black-out periods. Circular 1 maintains this as the basic rule. Black-out periods are defined as the duration of a postponement of ad hoc publicity of price-sensitive facts, the period of ten trading days prior to the release of financial results and whenever the last published consolidated accounts date back more than nine months (Circular 1, para. 13 ss.). As, therefore, an interruption of a buy-back program could be an indication of price-sensitive information being withheld due to a permitted postponement of ad hoc publicity, the Takeover Board accepted exceptions from the purchase restriction during black-out periods already in its practice under Comm 1.

Circular 1 now explicitly regulates the framework of exceptions from the purchase restriction during black-out periods by and large in line with the Takeover Board's past practice (para. 24 ss.). Therefore, purchases are permitted if they are delegated to a bank or securities dealer which executes purchases within the parameters set by the issuer and without further influence by the issuer. The issuer may, however, interrupt the program at any time (and take it up again outside black-out periods) or, outside black-out periods and no more than once a month, adjust the parameters and other instructions given to the bank or securities dealer.

If the issuer is itself a bank or securities dealer it may delegate the purchases to its own trading unit if it establishes information barriers (Chinese Walls). Compliance with this requirement must be confirmed by the regulatory auditor in accordance with article 17 Financial Market Audits Ordinance (para. 27).

ii. Limitation on Stock Exchange Buy-backs to 25% of the Daily Volume

Circular 1 (para. 29 s.) limits the volume of trades over the regular trading line to 25% (not including off-exchange block transactions). The wording of DraftCirc 1 seemed to extend this restriction, which was already included in Comm 1, to buy-backs through a separate trading line. Circular 1 makes clear that this limitation still only applies to purchases over the regular trading line (para. 29). It also clarifies that the basis of this restriction are the trades on the regular trading line only. In contrast to Comm 1, however, the basis is 25% of the volume traded on either the same day or the previous trading day (see the discussion in Gericke, Share Buy-back, op.cit. 16).

c) Duration and Reporting

Circular 1 limits the duration of buy-back programs to 3 years (para. 23). During the program, purchases and sales of the relevant securities must be reported every 5 trading days, block trades each day (para. 12 and 33). Purchases over a separate trading line do not have to be reported. One trading day after the termination of the program, the number of repurchased securities must be published (para. 53).

5) 10%-limitation of Article 659 CO

Further to prevailing criticism on the Takeover Board's scrutiny regarding the compliance with the 10% limitation set out in article 659 Swiss Code of Obligations (CO) in case of a buy-back by Partners Group Holding AG (TOB Order 408/01 dated 2 April 2009) and the proposal to adopt such practice in DraftCirc 1 (see the references cited in section 2 above), Circular 1 does not include that proposal. In addition, in re Transocean, the Takeover Board recently explicitly dropped the Partners Group practice (TOB Order 435/02 regarding Transocean Ltd., dated 24 February 2010, consid. 1/2, para. 8 ss.). According to that order, the Takeover Board will, in the future, remind issuers of their obligation to comply with article 659 CO, without, however, interpreting or applying the rule itself. Such review would be reserved to the civil courts.

6) Conclusions and Outlook on Proposed Auction Procedure

By the issuance of Circular 1 the Takeover Board modernized the framework of share buy-backs and clarified or explicitly regulated a number of questions. The Takeover Board did not hesitate to second-guess some of the proposals of DraftCirc 1 that met criticism in the commenting period and to make appropriate adjustments on the finishing line. As a result, while, as a matter of principle, some of the concerns on the

legitimacy and form of Circular 1 still hold true (see section 2 above and Gericke, Share Buy-back, op.cit. 12 s.) and certain of the new provisions may still deliver food for thought, Circular 1 by and large offers an adequate and practicable framework for share buy-backs.

It remains to be hoped that this positive outcome will not be impaired by the new proposal for the replacement of share buy-backs over a separate trading line by an auction procedure dated 22 March 2010 (the commenting period for which ended on 16 April 2010). Both the reasons for the proposal and the proposal itself do not seem to take into account that the separate trading line as a means of executing share buy-backs is driven by peculiarities of Swiss tax laws, which cannot be cured by the proposed procedure (see comments by Flavio Romerio/Claude Lambert dated 16 April 2010, publication forthcoming).

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FINMA'S Circular 2008/8 Definition of Public Advertisement Violates CISA, Says the Swiss Federal Administrative Court

Reference: CapLaw-2010-30

FINMA Circular 08/8 on Public Advertisement for Collective Investment Schemes, in note 9, defines the term "public advertisement" as any type of promotion not exclusively directed to qualified investors pursuant to article 10 (3) and (4) Collective Investment Schemes Act (CISA) and article 6 (2) of its implementing ordinance (CISO). The legality of this broad definition has been questioned in learned writing. An enforcement case of FINMA against a group of companies engaged in certain financial services activities without bank, broker-dealer and investment fund licenses which was appealed to the Federal Administrative Court now provides clarity on this question. Namely, the court held in its decision of 14 December 2009 that based on article 3 first sentence CISA a promotion which is addressed to a quantitatively and qualitatively limited circle of persons does not constitute public advertisement even if the targeted persons are not qualified investors. Due to appeals to the Federal Supreme Court, the decision, however, is not final. (The case is also of interest for other reasons than the CISA-issue discussed herein. Namely, the decision upheld FINMA's practice to consider, when assessing whether a conduct was subject to banking regulation, activities of related companies and parties as being carried out by one party located in Switzerland, subject to certain conditions. This group perspective means that the segmentation, and outsourcing to abroad, of different elements of an activity subject to licensing may not help to avoid the prudential supervision–and enforcement in the absence of the required licenses.)

By Sandro Abegglen

1) Implication of Public Promotion

The issue at hand is of certain importance as the public promotion (as opposed to non-public offerings) is the criterion which determines whether foreign collective investment schemes may be distributed in Switzerland without a license (see article 120 (1) CISA) and whether the person engaged in the marketing and offering thereof is subject to licensing as fund distributor (see article 19 CISA).

2) Activity was Promotion

In the case at hand, 14 persons and an investment volume of approximately CHF 6 million in the aggregate were invested in a foreign collective investment scheme (Fund). Among the investors were the complainant and promoter of the Fund as well as his son and sister, and further relatives and acquaintances of the promoter and the son, who apparently also engaged in the marketing of the Fund. In addition, apparently two persons not known to the complainant and his son were invested in the Fund. It was undisputed that the Fund qualified as a foreign collective investment scheme pursuant to article 120 (1) CISA. While the complainant denied to have engaged not only in public promotion but in *promotion (Werbung)* as such, the Federal Administrative Court concurred with FINMA which in its enforcement decree had held, in line with the majority view in learned writing, that informing persons about a specific collective investment scheme with the aim of soliciting such persons as potential investors was deemed to constitute promotion.

Furthermore, although apparently there had not been any direct evidence that the complainant had contacted some of the relatives, the Federal Administrative Court concurred with FINMA which had taken the view that given that it would be highly unlikely that such relatives would *invest by mere coincidence* and without having been made aware of the Fund by the promoters—such coincidental investment furthermore not having been alleged, nor substantiated by the complainant—promotion vis-à-vis such persons had to be assumed. While this point relates to the proper establishing of the facts based on non-direct evidence, one may nevertheless derive from the foregoing that unless a foreign collective investment scheme is a well known product and has attracted attention in the media etc., it indeed may not be plausible why a larger number of persons would be invested in a no-name fund on their own (non-provoked) initiative.

3) Note 9 Circular 08/8 Violates Article 3 CISA

The *Federal Administrative Court,* however, *dissented* with *FINMA's view* that the above described promotion *qualified as "public"* in the sense of article 3 third sentence CISA. FINMA in line with note 9 FINMA Circular 08/8 had held that the promotion had been done in a public manner because the investors were not qualified investors as defined by articles 10 (3) and (4) CISA and article 6 (2) CISO. First, the Federal Administrative Court recapitulated the well-established view that as a body independent of the

administration it was *not bound by administrative ordinances (Verwaltungsverordnungen)* such as the FINMA Circulars, and that an administrative court could only consider such ordinances to the extent they allowed for a correct interpretation of the applicable statutory rules in the case at hand. Thereafter the Federal Administrative Court addressed the material issue of the case and analysed the meaning of article 3 CISA. The court held that based on a *systematic interpretation* of the provision, sentences 2 and 3 of article 3 CISA provided for exemptions to the principle set forth in the first sentence of article 3 as adopting the opposite view would render the provisions' first sentence irrelevant, and that therefore the second and third sentences would not define (*e contrario*) the term *public* advertisement in a conclusive manner. Applying the *historic method* of interpretation, the Federal Administrative Court noted that the explanatory note of the Swiss government to the draft bill (*Botschaft*) of 23 September 2005 to CISA defined public promotion as any promotion which, without regard to form, is *not limited to a narrowly described circle of persons ("jede Werbung, die sich nicht an einen eng umschriebenen Kreis von Personen richtet").* The Federal Administrative Court further referred to the well-known Federal Supreme Court Decision BGE 107 I b 358, which held that an offering made to all 14,000 members of a German medical association was a public offering in the sense of the Investment Fund Act of 1966, and that a promotion could only be considered to have been made vis-à-vis a narrowly limited circle of persons if on the one hand the public was defined, and the other hand the public was small in number *("Die Werbung richtet sich nur dann an einen eng begrenzten Personenkreis, wenn einerseits das Publikum bestimmt ist, und anderseits dieses auch zahlenmässig klein ist.").* On such basis, the Federal Administrative Court concluded that a narrowly defined circle of persons was characterized by two aspects: the persons being determined (*e.g.* on the basis of pre-existing relationships) on the one hand, and the persons addressed being small in number *(zahlenmässig klein)* on the other hand and that, accordingly, in order to exclude a public promotion both quantitative and qualitative elements had to be assessed.

4) Imprecise Inversion by the Court

Unfortunately, while being absolutely correct in its result, the concrete assessment of the Federal Administrative Court in the case at hand appears to have been undertaken in an imprecise manner. In particular, after having made the above considerations, the court went on to state that the term *public* advertisement was defined by a qualitative and quantitative element. Such inversion is in so far incorrect, as read literally, it would mean that an offering made to a very large number of persons is not public if the circle of persons approached is defined.

Specifically, the Federal Administrative Court held that the larger part of the Fund's investors were relatives and acquaintances of the fund promoters, which constituted a narrowly defined circle of persons (qualitative element); in connection therewith, how-

ever, the court did not address the question whether the number of such persons (apparently just under 10) would fulfil the quantitative element. The quantitative element was only addressed by the Federal Administrative Court in respect of those two investors who had no pre-existing relationships with the fund promoters; in relation thereto the court said—rightly—that promotion vis-à-vis one or two interested parties would not be sufficient from a quantitative point of view to have the promotion be qualified as public.

5) Conclusion

As a preliminary conclusion with regard to the decision the following may be said:

- The Federal Administrative Court correctly held that note 9 FINMA Circular 2008/8 violates article 3 CISA in so far as it sets forth that non-public promotion requires the targeted investors to be qualified investors.

- Despite the criticism raised above regarding the inversion argument, it is very likely that the Federal Administrative Court, contrary to such literal reading of the inversion argument, takes the view that an offering to a large number of persons, even if the relevant circle of persons is defined, would constitute a public offering. In fact, in the case at hand the number of persons fulfilling the qualitative element was too small (below 10) to require an analysis of the quantitative element, and moreover the court explicitly referred to Federal Supreme Court Decision BGE107 Ib 358.

- It would also seem to follow from the decision that an offering to a small number of persons *per se* cannot be deemed to be public as such very term requires a certain size of persons approached. Hence, if read correctly, it is not correct to state (as, *in abstracto,* FSCD 107 Ib 358) that a *private offering* requires cumulatively a quantitative and qualitative element; rather, the correct answer should be based on a flexible interplay of the quantitative and qualitative elements meaning that a small number of persons approached may compensate for the non-existence of the qualitative element and vice versa so that even if the targeted persons are defined the sheer size of the quantitative element may superpose the qualitative element (as, *in concreto,* in FSCD 107 Ib 358).

- In other words, a promotion to a small number of persons, irrespective of whether such have a pre-existing relationship with the fund promoter or not, cannot be said to be public promotion *(öffentliche Werbung)* in the sense of article 3 CISA (and the same would seem to hold true for any promotion under any other financial services act and articles 652a Swiss Code of Obligations (CO) and 1156 CO). Because in the case at hand there were only two unrelated investors, naturally, the decision does not allow to determine up to which number specifically an offer can be qualified as non-public based on the quantitative element only.

– Against this background, and notwithstanding that the decision is apparently being appealed to the Federal Supreme Court, fund distributors for practical reasons may not rely on the Federal Administrative Court's decision as far as their strategic placement of non-licensed foreign funds is concerned (rather, they must rely on the qualified investor exemption for such purposes), but may use it for opportunistic offerings to a few selected persons.

– Finally, and notwithstanding that the decision remains of limited practical importance in its effect, it is from a rule of law point of view to be welcomed that the Federal Administrative Court insisted on a narrow interpretation of article 3 CISA and thereby upheld the principle of legality, as such provision does not only have a technical/regulatory relevance. One should in particular bear in mind (even though the court did not consider such point) that any public distribution of collective investment schemes in Switzerland without a license, even if done on a cross-border basis only, is subject to severe criminal sanctions (imprisonment of up to 3 years in case of intent and a fine of up to CHF 250,000 in case of negligence).

Against this background the decision of the Federal Supreme Court in this matter can be awaited with great interest.

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Structured Products—Quo Vadis?

Reference: CapLaw-2010-31

The collapse of Lehman had a significant impact on the Swiss market for structured products. Following a thorough review of current market practices the Swiss regulator FINMA announced in March to review current regulations with a view to improve investor protection. This article explains the background and reasons for this new regulatory initiative and speculates at its outcome.

By René Bösch

During the last ten years the market in Switzerland for structured products was developing significantly and with such growth rates that the regulator became increasingly concerned about the protection of investors in structured products. In a first attempt to at least partially regulate structured products in June 2005 the Swiss Federal Banking Commission published a position paper for public comment on the applicability of the investment fund regulation for structured products. That draft position paper was very much guided by the notion that structured products could actually constitute a form of investment funds that needed to be significantly regulated under Swiss law. However,

the draft position paper failed to recognize that in most instances structured products can be clearly distinguished from investment funds and that therefore investment fund regulations should not apply to the promotion and the distribution of structured products in Switzerland. It is thus not surprising that the draft position paper received harsh criticism from the industry and was never finalized nor implemented.

However, in connection with the deliberations on the new Collective Investment Schemes Act (CISA) (which is in force since 1 January 2007) the potential special regulation of structured products was again a hotly debated issue. After lengthy discussions and hefty inverventions by lobbying groups, it was agreed that CISA should not in detail regulate structured products but that in one particular provision of CISA certain requirements for the public offering and distribution of structured products in and from Switzerland shall be addressed. These requirements are mainly twofold: namely that a structured product may only be offered publicly in or from Switzerland if either the issuer, the guarantor or a distributor is a bank or a broker dealer that is duly licensed in Switzerland; and that a simplified prospectus be prepared for such public offering. The simplified prospectus was meant to be a short form prospectus that should briefly explain the most essential elements of the structured product offered but not necessitating an issuer description nor lengthy risk factors or the like. Oddly enough, the legislative history shows that it was the explicit intent of the legislator that the simplified prospectus needs to be available only at the time of issuance of the product, *i.e.*, at the issue date. The legislator gave regard to the customary practices in the market for structured products, namely that those products are initially offered on the basis of indicative terms, and that the final terms will only be fixed after such public offering, and that the final documentation is only prepared after the fixing of such final terms. This resulted in the rather unusual order that the simplified prospectus—the only offering document really needed from a Swiss law perspective for the public offering of structured products—must be available only at the issue date, that is usually *after* the products have actually been offered and sold to investors.

The simplified prospectus should look like an extended term sheet with summary information for the investors about the product that is easily apprehensible and comprehensible for average investors. As practice developed these term sheet–like simplified prospectuses became very technical in nature and were often available only after the market. Therefore, for the actual marketing of structured products before the issue date banks used fact sheets or similar documents describing the products.

The collapse of Lehman brought the market for structured products nearly to a halt. It took quite a long time until the market regained momentum and investors again started to show interest in structured products. In early 2009, however, the Swiss Financial Market Supervisory Authority FINMA (FINMA), the successor to the Swiss Federal Banking Commission, started an investigation into the practices relating to the distribution of structured products in Switzerland. Specifically FINMA focussed on the documentation practices, in particular whether the issuer risk was clearly described and whether the profit and loss potential was sufficiently described in the simplified prospectuses. After a thorough investigation of the prevailing market practices and the conduct of specific market players FINMA came to the conclusion that the documentation so far used in the Swiss market for the public offering of structured products was in full compliance with actual laws and regulations. *Ex post* FINMA, however, found certain regulatory standards to be unsatisfactory. It had already reacted in December 2008 to require that all documentation used for marketing purposes should contain improved risk disclosure legends.

On the basis of its findings in these investigations, published in early March 2010 in a paper relating to the Madoff-collapse and the distribution of Lehman-products, FINMA expressed its plan to revisit the regulation governing the distribution of structured products in Switzerland and to investigate whether new or amended rules would be necessary. On the one hand, it is expected that FINMA will focus on the distribution channel itself and may impose new rules in relation to the code of conduct for distributors, remuneration of distributors, supervision of distributors, etc. On the other hand it can be expected that FINMA also revisits the function and contents of the simplified prospectus and investigates whether new or amended rules on the disclosure requirements for the distribution of structured products will be needed.

The FINMA report of March 2010 will likely mark the beginning of a new rulemaking process in relation to the distribution of structured products in Switzerland. It can be anticipated that FINMA strives for more detailed rules about the way structured products are offered and distributed in Switzerland (where a particular focus may rest on the protection of retail investors). It will be interesting to see whether the current concept of the simplified prospectus will survive that scrutiny by FINMA. It will also be interesting to see how these new rules that FINMA is currently envisaging will reshape the Swiss market for structured products. Although it is not clear today and cannot be predicted what the new rules will be, we can anticipate that the regulatory landscape for the offering distribution of structured products in Switzerland will change over the next year or two.

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Daimler Settles U.S. Bribery Charges for $185 Million— A Forceful Reminder of the Need for Robust Compliance Programs

Reference: CapLaw-2010-32

The U.S. Securities and Exchange Commission (SEC) recently announced a $91.4 million settlement with Daimler AG for violations of the U.S. Foreign Corrupt Practices Act (FCPA). In addition, Daimler agreed to pay $93.6 million in fines to settle charges in separate criminal proceedings by the U.S. Department of Justice (DOJ).

For multinational companies, one of the best defenses against the risk of facing similar enforcement action, either in the U.S., Switzerland or elsewhere, is to establish robust compliance programs to help their employees deal with the pressures of doing business in difficult jurisdictions.

By Bernd Bohr / Stefan Sulzer

On 1 April 2010, the SEC and DOJ announced separate settlements with Daimler AG and three of its subsidiaries for FCPA violations, alleging that Daimler engaged in a repeated and systematic practice of paying bribes to foreign government officials to secure business in Asia, Africa, Eastern Europe and the Middle East.

Daimler and its subsidiaries agreed to pay $91.4 million in disgorgements to settle the SEC's civil charges and to pay $93.6 million in fines to settle charges in separate criminal proceedings initiated by the DOJ.

Copies of the SEC's press release and of the SEC complaint against Daimler are available on the SEC's Web site under the following link: http://www.sec.gov/news/press/2010/2010-51.htm. A copy of the DOJ's press release is available on the DOJ's Web site under the following link: http://www.justice.gov/opa/pr/2010/April/10-crm-360.html.

1) The U.S. Foreign Corrupt Practices Act

a) Anti-Bribery Provisions

The anti-bribery provisions of the FCPA make it unlawful for a U.S. person, and certain foreign "issuers" of securities listed on U.S. securities exchanges, to make a corrupt payment to a foreign official for the purpose of obtaining or retaining business for or with, or directing business to, any person. Since 1998, they also apply to foreign firms and persons who take any act in furtherance of such a corrupt payment while in the United States.

Daimler AG is directly subject to the provisions of the FCPA because its shares are listed on the New York Stock Exchange and are registered with the SEC. Swiss multinational companies that are directly subject to the provisions of the FCPA as a result of U.S. listings include ABB Ltd., Credit Suisse, Novartis AG, Syngenta AG and UBS AG. Many other Swiss companies conduct significant business in the U.S., either directly or through U.S. subsidiaries, and may therefore also be exposed to potential liability and U.S. enforcement action under the FCPA.

b) Record-Keeping and Internal Accounting Control Provisions

The FCPA also requires "issuers" whose securities are listed in the U.S. to meet its accounting provisions. These accounting provisions, which were designed to operate in tandem with the anti-bribery provisions of the FCPA, require companies covered by the provisions (1) to make and keep books and records that accurately and fairly reflect the transactions of the company and (2) to devise and maintain an adequate system of internal accounting controls to prevent and detect violations.

An issuer's foreign and domestic subsidiaries, even when wholly-owned, are generally not subject to the FCPA's accounting provisions. However, depending on the circumstances, including whether the issuer has a 50% or greater share in the subsidiary, the issuer may nevertheless incur liability for deficiencies in a subsidiary's recordkeeping and/or internal controls. Regardless of whether the subsidiary is controlled or non-controlled, the issuer will be liable under the FCPA's books and records provisions to the extent that its financial statements reflect deficiencies in the subsidiaries books and records. This problem is most likely to arise where the issuer and subsidiary file consolidated financial statements, but may also be a concern where the issuer's equity interest in the subsidiary is misstated in the issuer's financial statements. Where an issuer subject to the FCPA holds 50% or less of the voting power with respect to a subsidiary, the internal control provisions require only that "the issuer proceeds in good faith to use its influence, to the extent reasonable under the issuer's circumstances, to cause [the subsidiary] to devise and maintain a system of internal accounting controls."

c) FCPA Enforcement

The FCPA contemplates both civil and criminal penalties. The DOJ is responsible for all criminal enforcement and for civil enforcement of the anti-bribery provisions with respect to "domestic concerns" and foreign companies and nationals. The SEC is responsible for civil enforcement of the anti-bribery provisions with respect to "issuers."

The civil and criminal penalties and other sanctions under the FCPA can be severe. Companies that issue securities in the US are subject to fines of up to $2,000,000 per violation and individuals are subject to imprisonment of up to five years for violations of the anti-bribery provisions. Violations of the record-keeping provisions can carry fines

of up to $25 million for companies and 20 years in prison per violation for individuals. The Attorney General or the SEC, as appropriate, may also bring civil actions seeking injunctions and fines that, as demonstrated by the Daimler case, can reach into the many millions of dollars. In addition, prosecution or regulatory suit by the SEC may lead to debarment from US Government contracts.

2) Swiss Rules Against Bribing Foreign Officials

With effect as of 1 July 2006, article 322^{septies} of the Swiss Criminal Code similarly makes it unlawful in Switzerland to bribe foreign officials and violations can carry sentences of up to 5 years in prison or monetary fines for the individuals involved in the unlawful conduct.

According to article 102 (2) of the Swiss Criminal Code, companies may be criminally liable for violations of article 322^{septies} by their representatives in the course of conducting the company's business, if the company has not taken all necessary and reasonable organizational steps (*erforderliche und zumutbare organisatorische Vorkehren*) to prevent such crimes. Depending on the severity of the crime, the severity of the organizational failure and the severity of the damage cause by the crime, companies may face fines of up to CHF 5 million per violation.

3) International Anti-Corruption Framework

In 1999, the 30 OECD member countries (including the U.S., Switzerland and all EU countries) and eight non-member countries adopted the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The convention establishes legally binding standards that require all parties to the convention to criminalise bribery of foreign public officials in international business transactions. The 1999 Council of Europe Criminal Law Convention on Corruption contains similar provisions. As a result of these international treaties, all major industrialized countries and the vast majority of European countries have adopted criminal laws that outlaw bribing foreign officials.

Mostly recently (*i.e.* in April 2010), parliament in the United Kingdom enacted the Bribery Act 2010 (available at http://www.opsi.gov.uk/acts/acts2010/ukpga_20100023_en_1) which is in many respects even broader in scope than the FCPA. For instance, a company can defend itself only if it can establish that it "had in place adequate procedures designed to prevent persons associated with [the company] from undertaking such conduct". Unlike in the U.S., where prosecutors have certain discretion in evaluating a company's compliance policies and procedures in the context of weighing charging decisions and potential leniency, the UK statute establishes strict liability in the case of a bribe being paid for companies that failed to implement adequate compliance policies and procedures.

4) Recommendation

For a company doing business abroad, especially in jurisdictions where corruption may be widespread, the Daimler case should serve as a forceful reminder of the importance of robust anti-corruption programs and of having a strategy for dealing with potentially suspect transactions.

a) The Need for Robust Compliance Programs

For multinational companies, one of the best defenses against the risks of anti-corruption enforcement is to establish robust compliance programs to help their employees deal with the pressures of doing business in difficult jurisdictions—without clear guidance and the right "tone from the top", they may succumb to those pressures, with potentially disastrous consequences for both the company and the individuals involved.

b) Internal Investigations and Rewards for Cooperation

When confronted with a transaction that may potentially have been corrupt, companies must act quickly to determine all relevant facts in order to ensure that any improper acts have been stopped and to allow for considered decision-making regarding whether and how to report any violations to the relevant authorities.

It can be in the interest of a company that has violated the FCPA or other applicable anti-corruption laws to self-report its violations in order to receive reduced penalties as a result of cooperation.

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Cross-border Reinsurance Undertakings from Switzerland into the European Union

Reference: CapLaw-2010-33

By Petra Ginter

On 1 February 2010, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) acknowledged on behalf of its members the equivalence of Swiss reinsurance supervision with Directive (EC) 2005/68 on Reinsurance (EU Reinsurance Directive). CEIOPS has examined whether Swiss legislation on the supervision of reinsurance is equivalent to the EU Reinsurance Directive based on a catalogue of criteria produced and published by CEIOPS. This recognition reinforces cooperation between the supervisory authorities of the EU and Switzerland and is highly welcomed by FINMA.

However, the recognition of equivalence does not have a relaxing impact on the conditions for a Swiss reinsurance company to undertake cross-border reinsurance activity in the EU. The recognition does in particular not have the effect that Swiss reinsurance companies obtain passporting rights under the EU Reinsurance Directive as it is the case between member states of the EU. Such relaxation between Switzerland and the EU would require a respective agreement between the EU and Switzerland (comparable to the agreement between the EU and Switzerland on direct insurance, excluding life insurance, in force since 1 January 2003). Therefore, under current law, if a Swiss reinsurance company wishes to undertake cross-border reinsurance business into one or several member states of the EU, it has to carefully assess under the reinsurance regulation of each member state whether such activity is allowed and, if so, under what restrictions. In some EU member states the reinsurance regulator provides for a respective confirmation, whereas in others only legal opinions provided by local law firms may be available. The regulations may vary from (i) allowing to undertake reinsurance activity without the need for any license, registration or other requirements to comply with and without any limitations to observe (*e.g.,* with respect to visits, direct approaching/solicitation, use of local brokers, etc.), to (ii) a general prohibition to undertake reinsurance activity unless a licensed subsidiary or branch would be set up in the respective member state.

It remains to be seen whether this inadequate situation (not only for Swiss reinsurance companies, but also for EU insurance companies having the need to also locally diversify the hedging of their risks) will be reassessed and the single market for reinsurance will also become accessible for Swiss based reinsurance companies in the near future.

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Developments in Over-The-Counter (OTC) Derivatives Legislation

Reference: CapLaw-2010-34

Derivatives play an important role in the economy but are associated with certain risks. The financial crisis highlighted a number of problems in the over-the-counter (OTC) derivatives market, especially where transparency, market concentration and risk mitigation were concerned.

The financial crisis has brought derivatives to the forefront of regulatory attention. This article provides an update on the pending initiatives to regulate OTC derivatives in the U.S. and in the EU and outlines the key areas covered by such legislation.

By Thomas Werlen / Stefan Sulzer

Spectacular losses related to OTC derivatives played a significant role in the near-collapse of Bear Stearns in March 2008, the failure of Lehman Brothers in September 2008 and the U.S. government bail-out of AIG also in September 2008. These cases have highlighted the potentially devastating financial impact derivatives can have even on well established and sophisticated financial institutions and have led to a number of legislative and regulatory initiatives in the U.S. and in the EU.

1) United States

a) The House of Representatives

On 11 August 2009, the Obama Administration submitted to the U.S. Congress its draft reform legislation, the *Over-the-Counter Derivatives Markets Act of 2009* (for an overview of this draft legislation see Thomas Werlen/Stefan Sulzer, CapLaw-2009-58). In October 2009, the chairman of the House Financial Services Committee Barney Frank and the chairman of the House Agriculture Committee Colin Peterson submitted their legislative proposals, revising the Obama Administration's draft legislation.

On 12 December 2009, the House of Representatives passed the H.R. 4173, *the Wall Street Reform and Consumer Protection Act of 2009* (House Bill) (available at http://financialservices.house.gov/Key_Issues/Financial_Regulatory_Reform/FinancialRegulatoryReform/hr4173eh.pdf). The House Bill attempts to increase transparency, availability and reliability of information in the OTC derivatives markets by providing for the registration, supervision and regulation of swaps and swap market participants. Specifically, the House Bill:

(a) authorizes the U.S. Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) to regulate swaps, swap dealers, and certain end-users referred to as "major swap participants", defined as a non-dealer with a substantial net position in outstanding swaps (excluding commercial hedges), or

whose outstanding swaps create substantial net counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets;

(b) requires clearing of certain swaps if (i) a clearing organization will accept a swap for clearing, and (ii) the CFTC/SEC require that swap to be cleared;

(c) requires that all swaps that are subject to the clearing requirement also be traded on an exchange or on a swap execution facility;

(d) imposes minimum capital requirements and initial and variation margin requirements to help ensure safety and soundness of the swap markets;

(e) subjects swap dealers and major swap participants to recordkeeping, reporting, and business conduct requirements; and

(f) imposes size limits on positions, other than bona fide hedge positions, in physically-settled commodity transactions or options thereon, subject to certain exclusions.

b) The Senate

On 11 November 2009, the chairman of the Senate Banking Committee Christopher Dodd proposed legislation on OTC derivatives. On 15 March 2010, he submitted the *Restoring American Financial Stability Act 2010* (Dodd Bill) for U.S. Senate consideration. The Senate Banking Committee approved the proposed legislation on 22 March 2010 (available at http://banking.senate.gov/public/_files/TheRestoringAmericanFinancialStabilityActof2010AYO10732_xml0.pdf).

The OTC derivatives portion of the Dodd Bill is almost identical to the corresponding portion of the House Bill. It contains similar requirements with respect to central clearing, reporting and recordkeeping, minimum capital and margin, and position limits. The main differences are as follows:

(a) The definition of "major swap participant" in the Dodd Bill differs slightly in the second prong, which reads "or if such participant's failure to perform under the contract would cause significant credit losses to its counterparties" rather than, "or whose outstanding swaps create substantial net counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets";

(b) The Dodd Bill permits the CFTC/SEC to exempt major swap participants from the clearing requirement but, unlike the House Bill, this is a permission exemption as opposed to an automatic exemption. In addition, the exemption from the clearing requirement in the Dodd Bill for commercial hedges is narrower than in the House

Bill because of the requirement that a swap be an "effective hedge under generally accepted accounting principles";

(c) The Dodd Bill requires that all cleared swaps must also be traded on a regulated exchange or on an "alternative swap execution facility", the latter of which differs slightly from the House Bill and is defined as an electronic trading system with pre-trade and post-trade transparency in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made; and

(d) Cleared swaps will have a minimum capital requirement, and for non-cleared swaps, posting of margin will be required in order to "offset the greater risk to the dealer, participant and/or financial system".

The full Senate will debate and offer amendments to the Dodd Bill. If the Senate passes a bill, then it would be considered by the House of Representatives to deal with differences from the House Bill or be sent to conference of the House of Representatives and Senate for final resolution.

2) The European Union

In October 2008, EU Internal Market Commissioner Charlie McCreevy opened an investigation into the derivatives sector. He called a meeting with the industry and European regulators (i) to develop proposals as to how the risks from credit derivatives can be mitigated and (ii) to have a systematic look at derivatives markets in the aftermath of the lessons learned from the financial crisis. In July 2009, the European Commission identified the following four complementary tools to reduce the negative impact of OTC derivatives markets on financial stability: (i) increased standardization; (ii) the use of trade repositories; (iii) a strengthening of the use of central counter-party clearing houses (CCPs); and (iv) an increase in the use of organized trading venues (available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0332:FIN:EN:PDF).

In October 2009, the European Commission announced that it will come forward with comprehensive legislative proposals which will ultimately enable markets to price risks properly (available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0563:FIN:EN:PDF). These proposals are expected to reflect the goals formulated in the G20 Pittsburgh statement and, with regard to OTC derivatives, will be designed to:

(a) reduce counterparty risk by (i) proposing legislation to establish common safety, regulatory and operational standards for CCPs, (ii) improving collateralization of bilaterally-cleared contracts, (iii) substantially raising capital charges for bilaterally-cleared as compared with CCP-cleared transactions, and (iv) mandating CCP-clearing for standardized contracts;

(b) reduce operational risk by promoting standardization of the legal terms of contracts and of contract-processing;

(c) increase transparency by (i) mandating market participants to record positions and all transactions not cleared by a CCP in trade repositories, (ii) regulating and supervising trade repositories, (iii) mandating trading of standardized derivatives on exchanges and other organized trading venues, and (iv) increasing transparency of trading as part of the review of the Markets in Financial Instruments Directive (MiFID) for all derivatives markets including for commodity derivatives; and

(d) enhance market integrity and oversight by clarifying and extending the scope of market manipulation as set out in the Market Abuse Directive (MAD) to derivatives and by giving regulators the possibility to set position limits.

On 31 March 2010, the U.K. House of Lords EU Committee announced its support for the European Commission's plans for EU regulation of OTC derivatives. It is expected that a first draft of an EU law on OTC derivatives will be published in July 2010. The European Commission wants the new legislation to take effect from the end of 2012.

3) Co-ordinated Legislation

The market for derivatives is global. To avoid any risk of regulatory arbitrage and to ensure a global consistency of policy approaches, the European Commission announced that it stands ready to work with authorities around the world when finalizing its legislative proposals. In April 2010, Timothy Geithner, the U.S. treasury secretary, wrote a letter to Jean-Claude Trichet, president of the European Central Bank (a copy of the letter is available at http://media.ft.com/cms/7c9dca20-4bc4-11df-9db6-00144feab49a.pdf) and a similar letter to Michel Barnier, the European commissioner for the internal market, setting out a reform plan and calling for EU-US co-operation, which he said was essential to address systemic risk posed by OTC derivatives. In his letter, Timothy Geithner sets out four priorities for reform: (i) subjecting the market to substantial supervision and regulation, including conservative capital requirements; (ii) pushing all trading of standard derivative contracts onto exchanges or other regulated trading platforms; (iii) obliging all traders of standard derivative contracts to use CCP clearing; and (iv) giving regulators full authority to monitor transactions, including setting position limits.

4) Moving Forward

Many aspects of the proposed legislations may, of course, be modified as lobbyists, industry officials, and lawmakers engage in a debate over the appropriate scope of a future regulatory framework for the derivatives markets. Senators Jack Reed and Judd Gregg, for example, have already announced that they are working on significant amendments to the Dodd Bill's derivatives provisions, although the details remain un-

certain. It is also expected that Senator Blanche Lincoln, Chairman of the Senate Committee on Agriculture, Nutrition and Forestry (the Senate Committee that has primary responsibility for the futures markets and the CFTC), will submit a draft bill addressing derivatives regulation in the near future. The prospect of a new bill proposed by Senator Lincoln, coupled with the announced negotiation of a revised Dodd Bill, raise the possibility that significant changes will be made to the Dodd Bill. In the 100-seat Senate, 60 votes are needed to begin debate on the Dodd Bill. On 26 April 2010, the vote in the Senate fell three votes short, preventing immediate action on the bill. Only three days later, the Republicans in the Senate have dropped their objection and now allow debate on the Dodd Bill. We will continue to monitor and report on these proposals as the legislation evolves.

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Federal Supreme Court Dismisses Laxey's Appeal in Implenia Case

Reference: CapLaw-2010-35

Following the dismissal by the Federal Administrative Court on 18 December 2008 with respect to the decision by the Federal Banking Commission (now FINMA) that Laxey *et al.* did not comply with Swiss disclosure obligations set forth in article 20 of the Stock Exchange Act (SESTA), on 11 March 2010 the Federal Supreme Court also dismissed Laxey's appeal in the Implenia case. The Federal Supreme Court argued that the broad provision of article 9 (3) (d) of the Ordinance of the Swiss Federal Banking Commission on Stock Exchanges and Securities Trading (SESTO-FBC) then in force, which deals with indirect acquisition, interpreted by applying the reasoning behind article 20 SESTA (transparency, equal treatment of the market participants etc.), covered the investment strategy applied by Laxey *et al.* The investment strategy applied by Laxey, including the use of warehousing and contracts for difference, therefore, was subject to a disclosure obligation. The lack of legal certainty coming along with the open wording of article 9 (3) (d) SESTO-SFBC that was criticized by Laxey was found to be mitigated by the possibility to request a recommendation from the Disclosure Office or FINMA, respectively, and, therefore, article 9 (3) (d) SESTO-SFBC and the interpretation applied by the FBC and the Federal Administrative Court to be in line with the principle of clarity *(Bestimmtheitsgebot).*

Conference on Asset Management and Advisory (Vermögensverwaltung und Anlageberatung)

Friday, 11 June 2010, 09.05–16.50
SIX Convention Point, Zurich

www.irp.unisg.ch

St. Gall Corporate Law Day (St. Galler Gesellschaftsrechtstag)

Tuesday, 15 June 2010, 08.25–16.50
SIX Convention Point, Zurich

www.irp.unisg.ch

St. Gall Banking Law Day (St. Galler Bankrechtstag)

Tuesday, 22 June 2010, 08.55–16.40
SIX Convention Point, Zurich

www.irp.unisg.ch

Conference on Restructuring and Insolvency of Companies (Sanierung und Insolvenz von Unternehmen)

Wednesday, 30 June 2010, 09.15–17.15
Kongresshaus Zurich, Zurich

www.eiz.uzh.ch