Revised Swiss Insider Rules—A Change of Paradigm

Reference: CapLaw-2009-1

Rules on criminal insider trading have been introduced in the Swiss Penal Code more than 20 years ago, but only very few persons have actually been convicted. This situation is likely to change following a recent amendment of the law by which the term (price sensitive) 'fact' has been expanded significantly. Indeed, although barely noticed by the wider public, the revised law has led to a change of paradigm in Swiss insider legislation. The amendment is likely to have implications on regulatory as well as self-regulatory rules. This article will shed some light on the amendment as well as the Swiss regulatory regime on insider trading and market abuse in general.

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1) The Regulatory Regime on Insider Trading

Switzerland is not a member of the EU or the EEA and, hence, generally not bound by EU regulations on insider trading. The various standards addressing insider trading and fair market conduct are set out in various statutory provisions as well as regulatory rules ranging from criminal provisions to regulatory and self-regulatory rules. The most important provision, however, is article 161 of the Swiss Penal Code (PC).

a) Insider Trading under Criminal Law (article 161 PC)

What is insider trading: Article 161 PC incriminates, in essence, the misuse of privileged material non-public information. Article 161 (1) PC states that any person who, as a member of the board of directors, the management, the auditors or as agents of a company or its subsidiary or its parent company, as member of a government agency or as a public servant, or as auxiliary person of the afore-said, enriches itself or any other person (i) by taking advantage of the knowledge of material non-public facts whose disclosure will, in a foreseeable way, substantially influence the price of stock or other securities of a company or options thereon which are listed or pre-listed on an exchange in Switzerland, or (ii) by directing such material non-public facts to any third party, shall be punished with imprisonment up to three years or fine.

Who can be punished as primary insider: Importantly, only the type of persons expressly mentioned in article 161 (1) PC who have access to material, non-public information due to a privileged position *(Sonderdelikt)* qualify as ***primary insiders*** and, thus, can be punished under article 161 (1) PC. Accordingly, unlike in many other jurisdictions, shareholders who, by holding a sufficient amount of stock, have access to confidential information of the company are not listed in article 161 (1) PC. A shareholder would, nevertheless, become an insider if, due to its effective influence on the company, it qualified as a *de facto* officer.

Can tippees be punished: In addition to primary insiders, according to article 161 (2) PC, so-called ***tippees*** can be punished with imprisonment up to one year or a fine, if they receive the insider information (directly or indirectly) from a primary insider and enrich themselves or a third party by use of such information.

Significantly broadened definition of the term 'fact' under the revised law: As per 1 October 2008, the Swiss legislator expanded the scope of application of the insider trading provision by ***deleting para. 3 of article 161 PC.*** Para. 3 held that only upcoming initial public offerings, mergers and acquisitions or similar facts with comparable consequences were considered as facts that constituted privileged information the misuse of which could potentially lead to criminal sanctions against an insider. Under the revised law, the misuse of privileged information is no longer tied to a prescribed list of material facts.

Upon the deletion of the material list of relevant events, potentially ***all facts*** within the issuer which will significantly affect the market price of the securities in a foreseeable manner (both as regards materiality and direction), are considered relevant. This important development leads to a ***change of paradigm in Swiss insider law.*** For example, under the old law, financial information (*e.g.,* such triggering profit warnings) or results of clinical trials were, in principle, not covered by article 161 PC. The scope of (criminal) insider trading was hence extremely narrow and limited to material M&A and related activities.

Consequently, the question arises what ***'fact'*** means under the revised law. First of all, it can be assumed that the facts as explicitly named in the former para. 3 of article 161 PC, continue to fall within the scope of the law. Furthermore, material financial information will most likely be considered relevant facts under article 161 PC. The same applies to material business developments (*e.g.* important results of a clinical trial) or changes in financial results (e.g. profit warnings). As a rule of thumb, the term 'fact' will have to be interpreted in the same manner as for purposes of ad hoc publicity disclosure rules of the SIX Swiss Exchange (SIX; see below); however, this rule should be applied with caution, *inter alia,* because of the different nature of SIX regulations and criminal law.

Under the new law, the management of a Swiss listed issuer is under the constant risk of infringing article 161 PC because, by definition, management is permanently involved in confidential planning and financial review of the issuer. Thus, at what stage ***plans or projects*** of the issuer can be considered a 'fact' within the meaning of the revised law? Under the former law, the majority of Swiss doctrine held that plans can constitute facts within the meaning of article 161 PC, irrespective of how likely the execution is. In our view, however, the revised law calls for a more ***restrictive interpretation*** whereby the practice of the SIX regarding ad hoc publicity provides useful guidance. According thereto, mere rumours, ideas, planning alternatives and intentions do

not trigger ad hoc publicity disclosure obligations. In line therewith and based on the general principle of *'nulla poena sine lege',* a plan or project should be in a status of having a reasonable chance of being executed to constitute a 'fact' within the meaning of article 161 PC.

b) Other Relevant Rules

Market Manipulation under Criminal Law (article 161bis PC): A person undertaking to *manipulate* a security's price by communicating or distributing 'false' information to the public is not considered to be an insider pursuant to article 161 PC. However, subject to certain conditions being met, such person can be punished for market manipulation pursuant to article 161bis PC.

Ad Hoc Publicity Rules of SIX: Article 72 of the SIX Listing Rules sets out ad hoc disclosure duties for companies whose securities are traded on SIX. Special rules apply to Swiss issuers whose shares are traded on SWX Europe in London. However, due to the planned relocation of trading to SIX in Zurich mid-2009, the respective differences are likely to disappear soon. A breach of ad hoc disclosure duties may result in sanctions by SIX against the issuer. Under SIX Listing Rules, the issuer must inform the market of any price sensitive fact which has arisen in its sphere of activity and is not publicly known. Price sensitive facts are facts which are capable of triggering a significant price change (for further details, see: *http://www.six-swiss-exchange.com/admission/being_public/publicity_en.html*).

FINMA 2008/38 Circular on Market Abuse: Finally, the Swiss Financial Market Supervisory Authority (FINMA) circular 08/38 of 20 November 2008 (FINMA Circular 08/38; *http://www.finma.ch/d/regulierung/Documents/finma-rs-2008-38.pdf*) contains detailed regulations on the use and dissemination of price sensitive information, including examples of permitted and prohibited activities. The circular only applies to certain kinds of entities supervised by FINMA, *i.e.* licensed securities dealers and, within certain limitations, also to banks without securities dealer license and licensed institutions under the Collective Investment Schemes Act. The circular in part goes beyond arts. 161 and 161bis PC and, *inter alia,* intends to close certain gaps between Swiss law and the standards under the Market Abuse Directive of the EU (MAD).

2) Material Implications of the revised Article 161 PC

a) Implications for the Issuer: Organisational Matters/ Share Based Compensation

The provisions of the Penal Code on the ***criminal liability of enterprises are likely to become more relevant*** within the context of insider trading. According to article 102 (1) PC, a crime or offence shall be attributed to the enterprise if committed while it exercises a business activity within the scope of the enterprise and if such act

cannot be attributed to a natural person ***due to the deficient organisation of that enterprise.*** In such case, the enterprise can be punished with a fine up to five million Swiss Francs, leaving aside the potential adverse effect in terms of reputation.

This general rule being applied to the above discussed insider situation means that if a criminal offence described in article 161 (1) PC cannot be attributed to a specific insider because of the deficient organisational structure of the issuer, the latter can be punished subsidiarily. In order to avoid such punishment, a company should take the necessary organisational measures which enable it to identify suspects of insider trading offences. In the light of the broadened scope of article 161 PC, issuers of Swiss listed securities should, therefore, consider a ***review of their internal organisation and procedures in terms of (protection against) insider trading.*** Such review could, amongst others, cover the following aspects: (i) Status of existing internal insider policies and organisational regulations, (ii) possibility of blocked or supervised safe custody accounts of employees, (iii) maintenance of insider lists (note: different to article 6 (3) MAD, insider lists are not mandatory under Swiss law), and (iv) appointment of a Compliance Officer to implement, coordinate and supervise all measures to prevent insider trading.

Partly connected therewith, issuers may also have to review their existing procedures for setting-up, structuring and executing ***share based compensation*** schemes. For example, stock option plans as well as allocation and conditions of exercise of related options may (have to) be structured in a different manner in order to reduce the risk of potential insider trading issues.

b) Implications for Planned Transactions

With the broader term 'fact' under the revised article 161 PC, parties involved in transactions of listed companies or relevant Swiss listed securities, more than ever, must consider Swiss insider law implications. *E.g.,* if a party is offered access to information of a Swiss listed company in a due diligence process, the information gained therein may qualify as a fact under article 161 PC. From a Swiss criminal law perspective, this was much less of an issue under the former law where, *e.g.,* financial information or clinical data, was not covered by article 161 PC (see above) and the fact of the transaction as such may even have been exempted from article 161 PC based on the principle that 'nobody can be his own insider'.

The principle of ***'nobody can be his own insider'*** has been developed by Swiss doctrine. It concerns, inter alia, the question of whether, in a takeover situation, an acquirer of shares can be considered an insider or tippee, respectively, pursuant to article 161 PC. A not yet public, however likely to be executed, takeover plan may presumably be qualified as privileged material confidential information in the sense of article 161 PC. Nonetheless, the prevailing doctrine holds that the acquirer does not qualify as an in-

sider, or tippee respectively, in the case of a planned takeover because such plan is built in its own 'mind' and based on its own decision. *E.g.*, the above mentioned FINMA Circular 08/38 lists amongst permitted activities the purchase of securities of the target company by the potential acquirer itself, or by appointed third parties on account of the former, in preparation of a takeover. The circular also explicitly permits the repurchase of own securities within the framework of a share buy-back program pursuant to Release No. 1 of the Swiss Takeover Board regarding Equity Security Repurchases. It should be noted, however, that also Release No. 1 defines certain periods during which buy-backs must be suspended taking into account potential insider issues.

The rule that 'nobody can be his own insider' may no longer protect a party if such party acts based on ***price sensitive information which is not (clearly) related to the transaction*** in question. The issue is of particular importance in difficult market circumstances in which a potential counterparty to a listed company may no longer be able or willing to solely rely on publicly available information about the listed company before entering into a transaction.

Consequently, ***under the revised law, parties to a potential transaction will increasingly have to consider means to mitigate the risks of insider trading*** whereby traditional measures, such as the execution of confidentiality and standstill agreements and the keeping of insider lists, may not suffice in all circumstances.

SIX Swiss Exchange: Changes effective as of 1 January 2009 (or as indicated below)

Reference: CapLaw-2009-2

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Disclosure of shareholdings pursuant to article 20 Stock Exchange Act (SESTA) will have to be published by the issuer via the electronic publication platform operated by the SIX Disclosure Office (DO Publication Platform): The obligation to publish the notification in the Swiss Official Gazette of Commerce and in one of the main electronic media publishing stock market information has become obsolete. The Directive on Electronic Publication and Reporting Platforms issued by the SIX Admission Board provides technical details as well as the conditions how to use the DO Publication Platform (for further details see *http://www.six-swiss-exchange.com/admission/being_public/disclosure_en.html*).

SIX Group decides to reorganize securities market regulation and supervision of issuers and exchange trading: Regulatory and supervisory functions will be organizationally segregated from the operative business of the exchange. Moreover, the separ-