Commission's Report on New Stock Exchange Offences and Market Abuse Regulation

Reference: CapLaw-2009-27

On 29 January 2009 the commission of experts on stock market offences and market abuse set up at the request of the Federal Council submitted its report to the head of the Federal Department of Finance. The report contains proposals for new rules on insider trading and market manipulation. According to the experts, the offences should be brought more in line with the solutions applied in the EU and should no longer be contained in the Penal Code, but instead form part of the Stock Exchange Act. The Federal Council will decide in the coming months what further action is required and which of the proposed measures should be implemented after it has received additional clarification from the Federal Department of Finance.

By Philippe Weber / Petra Ginter

1) Background

On 3 October 2007, the Federal Department of Finance (FDF) appointed a commission of experts (the Commission) to inquire into and report on the Swiss rules and regulations on stock exchange offences and market abuse and to recommend what amendments could be made, inter alia, to bring the Swiss regime closer in line with EU and other relevant regulations. The report of the Commission was issued on 29 January 2009 and published in March 2009 (see http://www.efd.admin.ch/dokumentation/zahlen/00578/01375/index.html?lang=de).

The Swiss regime on the enforcement of stock exchange offences and other forms of market abuse consists of multiple layers of criminal provisions, supervisory law (both at statutory and lower regulatory levels) and self-regulatory rules. The current rules appear in part inadequate as to procedure and/or substance. In addition, they do not provide for the same level of protection against criminal conduct if compared to certain foreign laws, including EU law. Finally, according to international recommendations issued by the Groupe d'Action Financière (GAFI), insider trading and market manipulation should qualify as preceding offence *(Vortat)* of a money laundering offence, which currently is not the case under Swiss law.

Against this background, the Commission has formulated a series of proposals, including (in the annex to its report) a draft bill for a revision of the Stock Exchange Act (SESTA). The Commission is of the view that a modern and effective regime on stock exchange offences constitutes a precondition for a competitive Swiss capital market. If implemented, the proposed changes could lead to a significant overhaul of Swiss law on stock exchange offences and market abuse.

2) Findings and Proposals of the Commission

a) Place of Regulation and Related Matters

The Commission recommends to transfer the current provisions on ***insider trading and market manipulation*** from the Penal Code (PC) (*i.e.,* currently articles 161 and 161bis PC) to the SESTA.

Furthermore, the Commission proposes to introduce a new first degree incriminated conduct on insider trading and market manipulation that would qualify as ***crime*** *(Verbrechen)* if an insider trading or market manipulation results in a ***substantial financial profit***. Although the Commission expresses some reservations on this point, a new first degree provision would make it possible to qualify (severe) insider trading and market manipulation as preceding offence *(Vortat)* for a ***money laundering offence***. This would allow to implement the GAFI recommendations and to ratify the convention of the European Council.

These and certain other proposed amendments (see paragraph e) below) would facilitate a more ***uniform enforcement*** of market conduct rules and potentially the prosecution of multiple offences in accordance with the same procedural rules.

b) Insider Trading: Broadened Meaning of the Term 'Insider'

Primary Insiders: Under current Swiss law, ***only*** those categories of persons who are explicitly mentioned in article 161 (1) PC and who have access to material, non-public information due to a privileged position vis-à-vis the company *(Sonderdelikt)* qualify as ***primary insiders*** and, thus, are subject to criminal sanctions on insider trading under article 161 (1) PC (see CapLaw-2009-1). By contrast, in the UK or Germany the definition of 'insider' is broader and, *e.g.,* also includes persons who do not have a special relationship with the company.

The Commission concludes that the Swiss definition of 'insider' should be brought more in line with the EU Market Abuse Directive (MAD). Accordingly, it proposes to ***expand the definition of the primary insider to persons that have direct access to confidential information***, including, without limitation, persons that under current law qualify as auxiliary persons or as agents, such as assistants and legal advisors, as well as persons below the top management that have access to, or even produce, sensitive information. Different to current law, shareholders would also be covered by the new definition of primary insider. With respect to the origin of the insider information, it would furthermore be irrelevant whether the origin of the information lies within the relevant company (*i.e.,* the direct professional environment of the primary insider) or not; *e.g.,* also facts that occur outside of the relevant company but have an effect on the stock exchange price of the relevant company may qualify as insider information.

Secondary Insiders: The broader definition of 'primary insider' would automatically result in a broader meaning of the term 'secondary insider'. Any person that (directly and actively) receives information from a primary insider (as more broadly defined) would qualify as secondary insider and be subject to the criminal provisions on insider trading. In addition, and in accordance with the MAD, also persons that have received confidential information by committing a crime would newly be considered as secondary insiders.

Accidental Insiders: The Commission proposes that also persons that get access to confidential information only by coincidence should qualify as insiders, which is not the case under current law.

Safe Harbor: The Commission proposes a new safe harbor clause according to which the intention of a person to enter into a specific transaction would, as regards such person and third parties assisting that person in the execution, not per se constitute 'insider information'. For example, the acquisition of shares by the offeror in preparation of a planned tender offer would not, per se, be a punishable insider trading. This rule, which is often described as 'nobody can be its own insider', is widely accepted by Swiss legal scholars; however, by expressly including it in the statute legal certainty would be significantly increased.

Conclusion: If the above proposals will be implemented, Swiss law would level the playing field to the insider trading rule under the MAD. It would also facilitate cross-border transactions because the parties involved could rely on a more uniform regime of insider rules. For example, a transaction between insiders may be exempt from insider rules of country A whereas currently no such exemption may exist in country B.

c) Market Manipulation: Criminal Provisions remain Unchanged

Under the current article 161bis PC the definition of market manipulation is ***limited to the manipulation of the market price of securities***. By contrast, *e.g.,* in the UK and Germany the definition includes not only behaviour that affects the market price of securities but the market in general, *i.e.,* other important indicators such as trade volume or existing orders. In particular, whereas in Switzerland only 'Wash Trades' or 'Matched Orders' are forbidden transactions (to the extent they have an influence on the market price), the respective rules in the UK and Germany in addition include, *e.g.,* 'Cornering', 'Fixing the Close', 'Capping' and 'Pegging'. Based on the approach to cover such 'real' transactions (and not only simulated transactions), the rules in the UK and Germany contain specific guidance on what is considered as manipulating and non-manipulating behaviour as well as what behaviour is subject to 'Safe Harbours' or 'Accepted Market Practise'. *E.g.,* trading with own shares in the context of a buy back programme would be covered by these exemptions.

The Commission proposes ***not*** to expand the scope of criminal market manipulation (article 161bis PC) by including also simple rumours (as would be the case under the MAD). Also, an inclusion of further 'real' transactions which are prohibited under the MAD is not recommended by the Commission because such other 'real' transactions may only be divided into punishable and non punishable behaviour by the element of a good or bad intent which, in the view of the Commission, is an uncertain distinction. Therefore, the Commission believes that these behaviours should not be positioned as criminal provisions applicable to all market participants because it considers their value for the functioning of the stock exchange as less important. Instead, the Commission proposes that these provisions should remain of administrative character, *i.e.,* for regulated entities only, unless they are subject to the Limited Market Supervision as described below.

d) Limited Market Supervision

The Swiss Financial Market Supervisory Authority FINMA (FINMA) circular 08/38 of 20 November 2008 (FINMA Circular 08/38: http://www.finma.ch/d/regulierung/Documents/finma-rs-2008-38.pdf) as currently in force 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 entities supervised by FINMA, *i.e.,* licenced securities dealers and, within certain limitations, also to banks without securities dealer licence and licenced institutions under the Collective Investment Schemes Act.

The Commission proposes to introduce definitions of 'Volume Manipulation', 'Scalping' and 'Front Running' in the SESTA that would be sanctioned by limited administrative measures. This amendment would give FINMA the competence to enforce certain kinds of misbehaviour which formally do not qualify as (criminal) market manipulation. The proposal would not lead to prudential market supervision but would rather give FINMA the authority to investigate and enforce certain misbehaviour even if it were committed by a non-regulated participant (so-called 'Limited Market Supervision', in German *'Punktuelle Marktaufsicht').*

In order to enforce this conduct, the Commission proposes, in particular, the ***issuance of declaratory orders*** *(Feststellungsverfügungen)* and the ***disgorgement of profit***, each as administrative measures.

e) New Organisation of Competences for Enforcement of Stock Exchange Offences

On a procedural level, the goal of the Commission is to ***centralise the procedures to the largest extent possible***. The reason for this is not only because of the complexity of the matter but also because a perpetrator may, by one conduct, fulfil different definitions of offences. Therefore, the Commission is of the view that it does not make

sense if different authorities investigate into the same conduct. In order to achieve the described goal the Commission has considered various alternatives of which the following appears to be the preferred proposal:

The Commission proposes to assign all penal proceedings with respect to stock exchange offences to the competence of the ***Office of the Attorney General of Switzerland*** (OAG). This should, however, not undercut the existing practice that normally FINMA has the competence to undertake initial administrative investigations. As an introduction to the current practice, FINMA would, however, forward the results of its investigation to the OAG that is competent to initiate penal proceedings.

In connection with the proposed concept of the Limited Market Supervision by FINMA (as described above), ***FINMA*** would get the following competences with respect to the enforcement of stock exchange offences: It would be entitled ***to issue declaratory orders*** against non-regulated participants as an instrument to enforce its own proceedings with respect to stock exchange offences (as described in the preceding paragraph). This would be in line with current practice with respect to the violation of disclosure duties. Furthermore, FINMA would be authorised ***to impose the disgorgement of profit*** as administrative measure.

According to the preferred proposal of the Commission, the ***Federal Criminal Court*** (FCC) would act as first instance having judicial authority for stock exchange offences, which could be ***appellated to the Federal Supreme Court***. Consequently, under this proposal the Code of Criminal Procedures (StPO) would be applicable with respect to the procedural rights and duties of the perpetrator instead of the, to some extent, outdated Statute on Administrative Criminal Procedures (VStrR). Furthermore, it would abbreviate the process of judicial review.

As an ancillary issue, the Commission further proposes to shift the right to ***suspend voting rights according to article 20 (4bis) SESTA from the civil judge to the competence of FINMA***. As a supplementary measure, the Commission also encourages that FINMA should have the competence to issue an order that prohibits further acquisitions of securities *(Zukaufsverbot)* and that disgorges the profit (whereas, monetary fines should be reduced respectively).

3) Outlook

The Swiss government has announced that it will decide in the coming months what further action is required and which of the proposed measures should be implemented. Although implementation of the measures will require the amendment of Swiss federal statutes—and hence the approval of the Swiss parliament and potentially of the public by way of a referendum—it would not be surprising if in the current environment the Swiss government will support a fast procedure.

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