New Swiss Rules on Insider Dealing and Market Manipulation entered into force on 1 May 2013

Reference: CapLaw-2013-9

On 1 May 2013, the new Swiss rules on insider dealing and market manipulation entered into force. They bring about a fundamental change in Swiss administrative and criminal law and will have a significant impact on Swiss practice. Accordingly, issuers, financial institutions, advisers and other affected persons (meaning any other market participant in Switzerland) should familiarize themselves with the new rules and review their internal guidelines, procedures and standard forms to ensure compliance with these new rules and to make appropriate use of the safe harbours available under the new law. Further regulation will follow shortly; in particular, a revised FINMA circular on market behaviour rules, which will apply to all market participants, is expected to enter into force on 1 August 2013.

By Philippe Weber

1) Introduction

On 1 May 2013, the new Swiss rules on insider dealing and market manipulation entered into force. The main provisions can be found in the revised Stock Exchange Act (SESTA) and the amended implementing Stock Exchange Ordinance of the Swiss Federal Counsel (SESTO). In addition, the Swiss Financial Market Supervisory Authority (FINMA) has conducted a consultation process for a revised FINMA circular on market behaviour rules. The revised FINMA circular is expected to enter into force on 1 August 2013 and will apply to all market participants.

This article discusses the key changes coming with the revised law, namely:

- the ***new administrative law rules on market abuse*** (articles 33e and 33f SESTA), which (i) will be enforced by FINMA, (ii) apply to all market participants (*i.e.,* not only FINMA regulated entities), and (iii) apply irrespective of any intent and financial benefit on the part of any relevant person (differing from criminal market abuse); and

- the ***revised criminal law rules on insider dealing and market price manipulation*** (articles 40 and 40a SESTA), which will be prosecuted by the Swiss federal prosecutor and tried before the Swiss Federal Criminal Court.

In connection with these points, this article will also discuss (i) certain important safe harbours and other exemptions introduced by the Swiss government through the recently published revised SESTO, and (ii) key elements of the draft revised FINMA circular on market behaviour rules, which (1) will provide further guidance on how FINMA intends to apply the new administrative rules on market abuse, and (2) specifies further duties on FINMA regulated institutions.

2) The new administrative law rules on market abuse (articles 33e and 33f SESTA)

The revised SESTA introduces a new administrative law regime that prohibits all natural persons and legal entities from engaging in insider dealing and market manipulation. Prior to this, FINMA could only enforce market conduct rules against certain supervised market participants.

a) What constitutes market abuse *under administrative law*?

Under administrative law, market abuse comprises unlawful dealing with inside information (article 33e SESTA) on the one hand and market manipulation (article 33f SESTA) on the other hand:

i) Unlawful dealing with inside information (new article 33e SESTA)

Article 33e SESTA states that any person who knows or should know that information constitutes inside information acts unlawful if it:

(a) exploits *(ausnützt* (German)*/exploite* (French)*/sfrutta* (Italian)*)* such information to acquire or dispose of securities admitted for trading on a stock exchange or on a similar platform in Switzerland or if it uses financial instruments derived from such securities; or

(b) communicates such information to another person; or

(c) exploits such information to make a recommendation to another person to acquire, dispose of or use financial instruments regarding any securities covered by paragraph (a) above.

In this connection, the following three points are worth mentioning:

– "Inside information" means any confidential information which, if made public, would be likely to have a significant effect on the price of securities admitted for trading on a stock exchange or on platforms which are similar to stock exchanges *(börsenähnliche Einrichtung)* in Switzerland;

– the term "similar platform" should be limited to alternative trading systems which FINMA has expressly subjected to the SESTA/SESTO pursuant to article 16 SESTO, otherwise market participants would not be in a position to assess whether or not a security falls within the scope of market abuse rules; and

– according to the Swiss government's report of 31 August 2011 which was published together with the draft bill for the revised SESTA, *"exploit"* requires that the transaction was made based on the inside information, *i.e.* transactions which are

done despite the knowledge of inside information, but not based thereon, are not prohibited by article 33e SESTA.

ii) Market Manipulation (new article 33f SESTA)

Article 33f SESTA states that any person acts unlawful, if it:

(a) publicly disseminates information, of which such person knows or should know that this will send a false or misleading signal in relation to the offer, demand or price of securities admitted for trading on a stock exchange or on a similar platform in Switzerland; or

(b) carries out any transactions or executes buy- or sales orders, of which such person knows or should know that this will send a false or misleading signal in relation to the offer, demand or price of securities admitted for trading on a stock exchange or on a similar platform in Switzerland.

Unlike the criminal offence of market manipulation as defined in article 40a SESTA (and discussed in greater detail below), which only applies to simulated transactions, the administrative law regime will extend to real transactions carried out to manipulate the market for relevant securities. This significantly expands the scope of the provision to cover various manipulative practices such as squeezes, pump and dump schemes as well as naked short selling.

b) Are there any statutory safe harbours or other (potential) exemptions?

As indicated above, the new administrative law rules on market abuse have been drafted very broadly and, on their face, would also prohibit various accepted market practices. In paragraphs 2 of articles 33e and 33f SESTA, the Swiss government has therefore been authorised by parliament to issue rules on permitted behaviours (so-called "safe harbours").

Based thereon, the Swiss government has adopted a revised SESTO which entered into force on 1 May 2013 and provides several safe harbours as further described below. In addition, in its accompanying report to the revised SESTO the Swiss government provided additional guidance on (potentially) permitted behaviours. Finally, further guidance will be available once the revised FINMA circular on market behaviour has become final and enters into force.

i) Statutory Safe Harbour 1: Share Buy-backs (new articles 55b-d SESTO)

The new articles 55b-d SESTO contain ***detailed rules on buy-backs*** which, if followed, provide for a safe harbour under market abuse rules.

To a large extent, the SESTO provisions on buy-backs replace the rules previously set forth in the Swiss Takeover Board (TOB) Circular no. 1 about buy-back programmes. Consequently, the TOB has published a shortened Circular no. 1 about buy-back programmes and abolished its Circular no. 4 regarding exchange offers. In addition, the TOB has partially amended its Takeover Ordinance. The new TOB provisions entered into force on 1 May 2013 as well.

According to articles 55b-d SESTO, the safe harbour only applies to shares (*Beteiligungsrechte*). It therefore remains unclear whether and/or how buy-backs of debt securities will be treated under the new regime.

ii) Statutory Safe Harbour 2: Stabilization upon public offering (new article 55e SESTO)

According to article 55e SESTO, trading in securities for purposes of stabilization will be permitted pursuant to articles 33e (1)(a) and 33f (1) SESTA, if:

- this occurs within 30 days from the public placement of the respective securities;
- it is made at a price which is not higher than the offer price or, in case of subscription and conversion rights, not above their market price;
- the maximum period during which stabilization may occur and the identity of the securities dealer who has been appointed as stabilization agent have been published prior to start of trading of the relevant security;
- no prices are quoted while trading is suspended as well as during the opening and closing auctions;
- the stock exchange has been notified of any stabilization activities within 5 trading days and the issuer has published notice of such activities within 5 trading days from expiry of the stabilization period; and
- the issuer has informed the public within 5 trading days after exercise of any overallotment option about the time of exercise and the relevant number and type of securities.

According to article 55e SESTO, stabilization in case of public placements is exempt, *i.e.* the exemption would not be available in case of private placements. During the preparation of the revised SESTO, various practitioners had asked the Swiss government to revisit this position, unfortunately without success. In its accompanying report to the revised SESTO, the government justified its position by stating that (i) private placements normally regard non-listed securities, and (ii) in those exceptional cases where listed shares are placed privately, only selected investors would benefit from sta-

bilization, *i.e.* in contrast to public offerings, in private placements one could not invoke the trust of investors generally in financial markets and their functioning to justify an exemption.

This assessment, however, is not convincing. First, private placements of listed shares, including offerings by issuers (whether treasury shares or new shares), are increasingly common in Switzerland. Secondly, in case of offerings of listed securities, not only the subscribers of the offer shares will benefit from stabilization, but also the issuer, existing shareholders and any person who wishes to purchase or sell shares on a stock exchange, because all of them may be affected by short-term fluctuations resulting from the sudden increase in supply. This is particularly true in the case of private placements of new shares, in the case of large private placements of treasury shares and in cases where significant shareholders sell a large stake, which all are typically placed and priced by way of accelerated bookbuilding procedure and without a prospectus (unless the newly issued shares exceed 10% of the existing shares). Therefore, it would be helpful if the Swiss government would revisit its position in connection with the next revision of the SESTO. Pending this, market participants will have to consider whether any particular circumstances of the case may (exceptionally) permit stabilization within the parameters of articles 33e and 33f SESTO, *i.e.* without invoking a statutory exemption; however, this could be very risky both from an administrative and criminal law perspective.

iii) Statutory Safe Harbour 3: Certain other securities transactions (new article 55f SESTO)

Article 55f SESTO stipulates some very important exemptions in connection with securities dealings, exempting from article 33e (1)(a) and 33f (1) SESTA:

– transactions in securities to implement a person's own decision (commonly referred to as "nobody can be his own insider"), in particular the acquisition of shares in a target company by the potential offeror in preparation of a public tender offer (*i.e.* pre-offer stake-building), provided that the offeror has no (other) inside information;

– transactions in securities by the Swiss Confederation, cantons, communities and the Swiss National Bank in connection with the performance of their public duties, provided they are not made for investment purposes.

Importantly, while the government expressly recognises (within limits) the principle of "nobody can be his own insider", regrettably another principle, *i.e.* that dealings between insiders do not constitute insider dealing, has been expressly rebutted by the Swiss government on page 11 of its report accompanying the revised SESTO.

iv) Statutory Safe Harbour: Certain permitted communication of Inside Information (new article 55g SESTO)

Article 55g SESTO provides for the following important exemptions: Communication of inside information to another person will not be prohibited pursuant to article 33e (1) (b) SESTA, if:

(a) the recipient needs to have this information to perform its statutory or contractual duties; or

(b) the communication of such information is a prerequisite for the entry into a contract and the holder of inside information (i) cautions the recipient not to exploit the inside information, and (ii) puts on record the fact that inside information has been provided and that the recipient has received the cautionary statement.

In order to fall under the "contractual duties" exemption referred to under (a) above, the respective contract must have been entered into in compliance with applicable law. Accordingly, the exemption referred to under (a) covers, for example, the passing on of inside information to a mandated adviser in connection with a transaction or the giving of information to an employee's superior or to the board of directors of an issuer. In cases where the existence of statutory or contractual duties is not evident, it will be important to enter into appropriate written arrangements and adopt appropriate internal guidelines on dealing with insider information and trading.

The exemptions described above under (b) cover, for example, the provision of information in connection with pre-sounding activities and the granting of due diligence access to potential bidders in the context of an M&A transaction. In these cases it will be important that confidentiality and standstill agreements, leak contingency plans and other guidelines (***e.g.***, data room rules) are drafted appropriately and take into account the new legal requirements.

The safe harbour list in article 55g SESTO is expressed to be exhaustive. In particular, it does not give authority to the government or to another body (***e.g.***, FINMA) to grant further exemptions. This is unfortunate because it is almost impossible to cover in advance all activities which, on the one hand may fall within the scope of the prohibited market abuse behaviours covered by articles 33e and 33f SESTO, but which on the other hand may indeed constitute accepted market practice. To illustrate, according to article 53 of the SIX Listing Rules, an issuer is obliged to publish price sensitive information, but this case is not expressly mentioned in article 55g SESTO, nor is it entirely clear that a rule adopted by a stock exchange (even if approved by FINMA), will formally suffice to create an exemption from a prohibition set forth at a statutory level.

Finally, market participants will have to bear in mind that article 55a SESTO only provides a safe harbour for the passing of inside information covered by article 33e (i)

(b) SESTO; it does not dispense of the restrictions set forth in article 33e(i)(a) and (c) SESTO regarding the use of inside information and regarding the issuance or related recommendations.

v) Other (potentially) permitted behaviour (Accompanying Report of the Swiss Federal Council)

In its accompanying report to the revised SESTO, the Swiss government has clarified that the following behaviours would not fall within the scope of articles 33e and 33f SESTO and, therefore, no express exemptions/safe harbours are necessary in such events:

- transactions in securities done with the knowledge of inside information, but where the knowledge of such information has no influence on the transaction, ***e.g.***, the maintenance of an existing investment strategy which has been defined independently from the inside information, the exercise of rights of first refusal based on a shareholders agreement at the (pre-determined) purpose to maintain control; by contrast, the revocation of an order based on inside information would not be exempted;

- price management (*Kurspflege*), meaning providing liquidity to the market through the issuer or a third party mandated by the issuer in order to reduce large price-swings (as long as respective entries into the order book or executions send no misleading signals to market participants);

- market making to provide liquidity at the same time for both buy- and sell-orders and to narrow the difference between bid and ask price;

- the nearly simultaneous placing of buy- and sell-orders for the same securities on different market places for arbitrage purposes.

vi) Revised FINMA circular regarding Market Behaviour Rules

In 2008, FINMA issued a circular on market conduct rules. The circular only applied to regulated securities dealers, banks and certain types of licensees under the Collective Investment Schemes Act.

With the entry into force of the new market abuse rules under the SESTA and SESTO which apply to all market participants, the FINMA circular requires a complete overhaul. A draft of the revised circular (FINMA Circular) together with an accompanying report have been published by FINMA for consultation on 27 March 2013. The consultation ended on 13 May 2013. The revised circular is expected to enter into force on 1 August 2013.

The first part (sections III-V) of the draft FINMA Circular provides for general rules on preventing insider information and market manipulation. They will apply to all natural persons and legal entities active in the financial market. Different to its predecessor (FINMA Circular 38/2008), the draft FINMA Circular contains only a short list of permitted behaviours. In turn, it introduces a relatively long but still not exhaustive list of prohibited practices, such as painting the tape, cornering, ramping, scalping, spoofing, wash trades, banging the close, etc. While this will provide helpful guidance to market participants, it should be noted that FINMA will reserve the right to assess transactions on a case-by-base basis, *i.e.* FINMA may deviate from the list if particular circumstances of a case so require.

In the second part (sections VI and VII), the draft FINMA Circular contains the following important additional rules, which, however, will only apply to FINMA supervised institutions:

- ***Primary markets, foreign securities and other secondary markets***: In order to assess the proper business conduct of an institution under prudential supervision, Section VI of the draft FINMA Circular prescribes that not only securities dealing on Swiss stock exchanges are relevant; it states that the new SESTA/SESTO rules on dealing with insider information and market manipulation will apply *mutatis mutandis* to (i) securities dealing in the primary market as well as to dealings on foreign stock exchanges, and (ii) business activities on other markets, including regarding commodities and foreign exchange.

- ***Market abuse related organizational requirements***: Section VII of the draft FINMA Circular sets forth organisational requirements to ensure proper market behaviour, taking into account recent experience and, where possible, international standards. These organisational requirements are no longer directed exclusively at securities dealers, but at all institutions under prudential supervision. The requirements relate to dealing with unlawful activities, including notification duties, Chinese walls, supervision of employees and other relevant persons, watch lists and restricted lists, duty to record, high frequency trading and review duties. These requirements will not be the same for every supervised institution, rather they will apply on an individual basis depending on its business activities, size and structure. The organisational measures necessary will have to be defined according to a risk assessment that needs to be conducted regularly.

From the above it follows that FINMA supervised institutions are required to review their organisation and guidelines to ensure compliance not only with the new SESTA/SESTO rules, but also the additional requirements set forth in sections VI and VII of the draft FINMA Circular.

c) Who is responsible for enforcement of the administrative law market abuse rules and what are the sanctions in case of breach?

As stated in the introduction, enforcement of the administrative law market abuse rules against all market participants will be the responsibility of FINMA. For such purpose, FINMA will have quite far reaching investigative powers.

By contrast, FINMA will have limited means to sanction unlawful behaviour. Pursuant to article 34 SESTA, permitted sanctions will include the issuance of a declaratory decision, publication of such decision (so-called "naming and shaming») and confiscation of unlawful profits. Vis-à-vis FINMA supervised institutions, FINMA will retain further reaching sanction rights, including those set forth in the FINMAG and in article 35a SESTA (ban from profession, etc.).

3) Market Abuse under Criminal Law

The new Swiss rules on market abuse also introduce important changes under criminal law. On the one hand, the provisions on criminal insider dealing and market price manipulation have been transferred from the Criminal Code into the SESTA. On the other hand, and more importantly, the offence of insider dealing has been substantially expanded and stated more precisely, while in substance the offence of market price manipulation has remained unchanged. In addition, both offences are newly subjected to federal jurisdiction.

a) What constitutes market abuse *under criminal law*?

Under the new rules, criminal market abuse comprises ***insider dealing*** (article 40 SESTA) on the one hand and ***market price manipulation*** (article 40a SESTA) on the other hand:

i) Insider Dealing (new article 40 SESTA)

According to the new article 40(1) SESTA, will be punished with of up to three years of prison or with a fine, any person, who as an officer or member of an executive or supervisory body of an issuer or a person controlling or controlled by the issuer, or as a person who due to its participation or activity is supposed to have access to inside information (all such persons being "primary insiders"), obtains for itself or for another person a financial advantage by:

(a) exploiting such inside information to acquire or dispose of securities admitted for trading on a stock exchange or on a similar platform in Switzerland or by using financial instruments derived from such securities; or

(b) communicating such information to another person; or

(c) exploiting such information to make a recommendation to another person to acquire, dispose of or use financial instruments regarding any securities covered by paragraph (a) above.

If the financial advantage resulting from an act covered by article 40(1) SESTA exceeds CHF 1 million, the sanction will be up to 5 years of prison or a fine (article 40(2) SESTA). This also means that such qualified cases will become predicate offences to money laundering.

While articles 40(1) and 40(2) SESTA deal with offences by primary insiders, article 40(3) SESTA stipulates that so-called "tippees", meaning persons who have received inside information from a primary insider pursuant to article 40(1) SESTA or through (another) crime or felony, will be punished with prison of up to one year or a fine if they obtain (for themselves or another person) a financial advantage by exploiting such inside information to acquire or dispose of securities admitted for trading on a stock exchange or on a similar platform in Switzerland or by using financial instruments derived from such securities.

Finally, pursuant to the new article 40(4) SESTA, those persons who are not a primary insider or a tippee pursuant to article 40 (1)-(3) SESTA will also be punished with a fine if they obtain (for themselves or another person) a financial advantage by exploiting inside information to acquire or dispose of securities admitted for trading on a stock exchange or on a similar platform in Switzerland or by using financial instruments derived from such securities.

From the above it follows that the Swiss criminal law provisions regarding insider dealing have been expanded in many respects. Namely, the term "primary insider" is much wider than before, the scope of prohibited actions has been broadened, and the potential sanctions are heavier. Moreover, even persons who accidentally become aware of inside information are now covered.

ii) Market Price Manipulation (new article 40a SESTA)

Different to insider dealing, the criminal law rules on market price manipulation have essentially remained unchanged, other than transferring them from the Criminal Code to the SESTA. According to article 40a(1) SESTA, any person will be punished with of up to three years of prison or with a fine, who, with the aim to significantly influence the price of securities admitted for trading on a stock exchange or on a similar platform in Switzerland and thereby to achieve a financial advantage for itself or another person

(a) against better judgment disseminates wrong or misleading information, or

(b) effects sales and purchases of securities, which on both sides directly or indirectly are made for the account of the same person or persons that are affiliated for such purpose.

If the financial advantage exceeds CHF 1 million, the sanction will be up to 5 years of prison or a fine; *i.e.* such qualified cases of market price manipulation will also constitute predicate offences to money laundering.

As stated above, part (b) of the definition of market price manipulation under criminal law is much narrower than under administrative law in that it is limited to simulated transactions.

b) Are there any statutory safe harbours or other (potential) exemptions?

First of all, and different to market abuse under administrative law, any breach of the market abuse provisions under criminal law requires that the offender acted with intent (*Vorsatz*). Accordingly, an offender cannot be punished under article 40 (Insider Dealing) SESTA or article 40a (Market Price Manipulation) SESTA if he acted only negligently—but in such case he may nevertheless face sanctions under administrative law (see section 2 above) or civil liability. The same is true if the condition of "financial advantage" is not fulfilled.

Page 4 of the accompanying report of the Swiss government relating to the revised SESTO contains an important statement clarifying that by virtue of article 14 of the Swiss Criminal Code, the safe harbours and exemptions applicable to market abuse as set forth in the SESTO (see section 2.b above) also apply in relation to the market abuse provisions under criminal law.

Another important point to bear in mind is that because qualified cases of criminal insider dealing and market price manipulation by primary insiders constitute predicate offences to money laundering, financial intermediaries will be expected to monitor their clients to detect such insider dealing and market price manipulation. Consequently, persons qualifying as potential primary insiders (***e.g.***, executives of listed companies, auditors, lawyers, etc.) may need to be treated as high(er) risk clients who require more monitoring (see also note 39 of the draft FINMA Circular which stipulates a notification duty of FINMA supervised institutions vis-à-vis FINMA with respect to material breaches of articles 33e and 33f SESTA).

c) Who is responsible for the enforcement of the criminal law market abuse rules?

According to article 44 SESTA, criminal insider dealing and market price manipulation are subjected to federal jurisdiction, *i.e.* cantonal authorities are no longer competent, the prosecution will be the responsibility of the Office of the Federal Attorney General of Switzerland (*Bundesanwaltschaft*), and the court of first instance will be the Swiss Federal Criminal Court (*Bundesstrafgericht*).

4) Conclusions

The revised Swiss administrative and criminal law rules regarding market abuse bring about a fundamental change of Swiss law and practice:

- A new administrative law regime has been introduced, which applies to all market participants, not only to securities dealers, banks and certain entities operating under a collective investment act license as in the past.

- In terms of substance, the scope of the Swiss market abuse rules, both under administrative and criminal law, has been significantly broadened.

- The revised rules call issuers, financial institutions, advisers and other affected persons to review and update their internal procedures and guidelines (*e.g.*, trading and communication guidelines, leak contingency plans, etc.) and standard forms (*e.g.*, confidentiality and standstill agreements) to ensure compliance with the new rules and to make appropriate use of the various safe harbours provided; in connection with this the revised FINMA circular on market behaviour, which is expected to come into force on 1 August 2013 and which will newly apply to all market participants, needs to be taken into account.

- Prudentially, FINMA supervised institutions will additionally have to take into account the special requirements applicable to them pursuant to the revised FINMA circular, including the additional market abuse related organizational requirements as well as the extended application of Swiss market behaviour rules in relation to primary markets, foreign securities and non-securities related markets.

Philippe Weber (philippe.a.weber@nkf.ch)

Overhaul of Swiss Corporate Governance Regime for Listed Swiss Companies Following Approval of the Minder Initiative

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On 3 March 2013 a constitutional amendment was approved by the Swiss voters as proposed by the Minder say-on-pay initiative. By the end of May 2013, the Federal Office of Justice is expected to publish a draft implementing ordinance, which will be enacted on 1 January 2014. The implementing ordinance will overhaul the Swiss corporate governance regime for listed Swiss companies pending the enactment of a revised statute of law.

By Ralph Malacrida

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Editors:
René Bösch
Thomas U. Reutter
Philippe A. Weber
Thomas Werlen