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# New Regulatory Documentation Requirements and Procedures for Issuing Fixed Income Instruments in the Swiss Market

Reference: CapLaw-2010-12

The new Book-Entry Securities Act (BESA), also referred to as Federal Intermediated Securities Act (FISA), that entered into force on 1 January 2010 lead to some changes in the process of issuing and documenting securities in the Swiss capital market. This article describes the background of these changes and certain procedures and documentary issues in relation to the issuance of bonds and derivatives in the Swiss market.

*By René Bösch / Eduard De Zordi*

On 1 January 2010, the Federal Book-Entry Securities Act (BESA) entered into force, bringing with it modifications that have implications on the issuance of bonds and derivatives in Switzerland.

Issues of bonds or derivatives may still be represented by permanent global certificates, as was the case before the entry into force of the BESA, and may now, under the BESA, also take the form of uncertificated securities. The modifications in the documentation pertaining to issues in the form of uncertificated securities *(Wertrechte)* are more substantial than the modifications in relation to issues in the form of permanent global certificates.

We will first discuss some general matters in relation to uncertificated securities and then discuss the modifications to the documentation relating to issues in the form of uncertificated securities and to issues in the form of permanent global certificates.

## 1) Uncertificated Securities in General

Together with the introduction of the BESA, the concept of uncertificated securities has now been codified in the Swiss Code of Obligations and the legal regime for Swiss issuers of uncertificated securities has been defined. A Swiss issuer can newly issue uncertificated securities and can also replace fungible securities or permanent global certificates, which have been deposited with a single intermediary, with uncertificated securities, provided that the terms and conditions of the offering or the articles of incorporation allow such exchange or that the depositors have agreed thereto.

The issuer keeps a non public register of the uncertificated securities (so-called *Wertrechtebuch*), in which the number and par value of the uncertificated securities issued as well as the first creditors, respectively holders shall be recorded:

– If an issuer sells uncertificated bonds via a lead manager by means of a firm underwriting, the first creditors to be recorded in the Register of uncertificated securities shall be the lead manager or the managers.

– In case an issue is not sold to one or more managers, the issuer itself may be recorded as first taker, respectively first creditor.

The registration in the register of uncertificated securities is a condition for the creation of uncertificated securities, *i.e.,* uncertificated securities are created by the entry in the register of uncertificated securities at the time of such entry and exist pursuant to such registration. The effective date of the creation of the uncertificated securities may be postponed to a later date, *e.g.,* the closing date ("as of…."), which will probably be the general standard.

### 2) Issues in the Form of Uncertificated Securities

It is important to note that book-entry securities, also referred to as intermediated securities, that are based on uncertificated securities are created with their registration in the main register of an intermediary (*i.e.,* SIX SIS Ltd or another clearing organization) and the credit entry in the securities account(s) of the participants. Therefore, in the issuance process, the uncertificated securities must be created (even if only with effect as of the closing date), in order that, based thereon, the lead manager may create the intermediated securities in the systems of SIX SIS Ltd and transfer such intermediated securities to the securities accounts of the managers upon closing.

The subscription or purchase agreement as well as the terms and conditions of the bond issue need to be adjusted to reflect these mechanics and to provide a solid basis for the issuance of the bonds in the form of uncertificated securities. The main points to be addressed in the underwriting documentation are, *inter alia,* the following:

– the obligation of the issuer to create the uncertificated securities and to record them in the register of uncertificated securities *(Wertrechtebuch);*

– the obligation of the lead manager or principal paying agent to enter the uncertificated securities in the main register *(Hauptregister)* of SIX SIS Ltd or other intermediary;

– the obligation of the issuer to deliver to the lead manager prior to the closing date a duly signed copy of the its uncertificated securities register, in which the bonds or derivatives are duly registered with effect as of the closing date at the latest and the

lead manager or the managers is/are designated as first creditor(s) of the bonds or derivatives;

- the covenant of the issuer to keep the register of uncertificated securities in its records and not to make any amendment to the entry in the register of uncertificated securities relating to the bonds except a reduction of the bonds or derivatives in accordance with cancellations effected through the principal paying agent or lead manager until final redemption of the bonds or derivatives; and
- the covenant of the issuer not to effect the registration of the bonds or derivatives in any main register *(Hauptregister)* according to article 6 para 1 section c BESA other than the registration in the main register of SIX SIS Ltd through the principal paying agent or lead manager as specifically agreed.

Further, in relation to bonds or derivatives to be listed at the SIX Swiss Exchange (SIX) it must be noted that the listing rules of the SIX require the disclosure of the rules on how the securities may be transferred via the stock exchange as well as on the proof of legal ownership of the securities.

### 3) Issuance of Uncertificated Securities by Foreign Issuers?

The new legal provisions regarding the offering of uncertificated securities primarily apply to companies having their registered office in Switzerland. Foreign companies are not automatically subject to these rules, they may however choose Swiss law as the governing law of an issue, in which case the rules regarding uncertificated securities of the Swiss Code of Obligations would also apply to issues by foreign companies.

The BESA does not provide that only Swiss uncertificated securities are admitted for the creation of intermediated securities. In fact, uncertificated securities of foreign issuers governed by foreign law are also admissible. For this purpose it is necessary to make sure that such uncertificated securities governed by foreign law have the same function as Swiss uncertificated securities. Lead managers of bonds or derivatives to be issued in uncertificated form may require that foreign counsel provides comfort on these aspects by means of a legal opinion.

### 4) Issues in the Form of Permanent Global Certificates

In case of issues in the form of permanent global certificates, the main adjustments relate to the terms and conditions, in which the regulations of the BESA need to be reflected.

Under most foreign issuance programs, issues are represented by permanent global certificates. In that case, the amendments primarily regard the terms and conditions on the form of the issue. The difference to stand-alone documentations lies in the fact

that in issuance programs the terms and conditions are determined in the issuance program and need to be amended and supplemented by means of an additional section in the final terms.

The wording for such additional section in the final terms, in this example for a bond, may provide for and read as follows:

> The Bonds and all rights in connection therewith are documented in the form of a Permanent Global Certificate [in accordance with article 973b of the Swiss Code of Obligations *(Globalurkunde)*] which shall be deposited by the Principal Paying Agent with SIX SIS Ltd or any other intermediary in Switzerland recognized for such purposes by SIX Swiss Exchange Ltd (SIX SIS Ltd or any such other intermediary, the **"Intermediary"**). [Once the Permanent Global Certificate is deposited with the Intermediary and entered into the accounts of one or more participants of the Intermediary, the Bonds will constitute intermediated securities *(Bucheffekten)* **("Intermediated Securities")** in accordance with the provisions of the Swiss Federal Intermediated Securities Act *(Bucheffektengesetz).*
>
> Each Holder (as defined below) shall have a quotal co-ownership interest *(Miteigentumsanteil)* in the Permanent Global Certificate to the extent of his claim against the Issuer, provided that for so long as the Permanent Global Certificate remains deposited with the Intermediary the co-ownership interest shall be suspended and the Bonds may only be transferred by the entry of the transferred Bonds in a securities account of the transferee.
>
> Neither the Issuer nor the Holders shall at any time have the right to effect or demand the conversion of the Permanent Global Certificate *(Globalurkunde)* into, or the delivery of, uncertificated securities *(Wertrechte)* or definitive Bonds *(Wertpapiere).*
>
> No physical delivery of the Bonds shall be made unless and until definitive Bonds *(Wertpapiere)* shall have been printed. Bonds may only be printed, in whole, but not in part, if the Principal Paying Agent determines, in its sole discretion, that the printing of the definitive Bonds *(Wertpapiere)* is necessary or useful. Should the Principal Paying Agent so determine, it shall provide for the printing of definitive Bonds *(Wertpapiere)* without cost to the Holders. In the case definitive Bonds *(Wertpapiere)* are delivered, the uncertificated securities *(Wertrechte)* will immediately be cancelled by the Issuer and the definitive Bonds *(Wertpapiere)* shall be delivered to the Holders against cancellation of the Bonds in the Holders' securities accounts.

Further, with respect to all offerings (stand-alone or under programs), the subscription respectively purchase agreement needs to provide that the signed permanent global certificate shall be delivered to the lead manager before closing. The lead manager

will now have to confirm vis-à-vis SIX SIS Ltd by means of the redrafted form "Delivery Undertaking" of SIX SIS Ltd *(Lieferversprechen)* that it will come into possession of the permanent global certificate signed by the issuer at the latest on the *day before the closing* and that it will hold the permanent global certificate as direct possessor on behalf of SIX SIS Ltd until submission of the permanent global certificate to SIX SIS Ltd. Therewith, the legal requirements are met for the trading with the intermediated securities to be able to start on the morning of the closing.

Finally, the description of the form of the issue also needs to be amended in the wording of the permanent global certificates. For the sake of transparency, the permanent global certificate should explicitly mention that investors have no right of conversion into or delivery of definitive certificates or uncertificated securities.

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## Article 20 Stock Exchange Act and Disclosure Obligations of Foreign Collective Investment Schemes

Reference: CapLaw-2010-13

Under Swiss Law, certain reporting duties exist as far as direct or indirect acquisitions or sales regarding Swiss listed companies are concerned. While beneficial ownership normally is the decisive criterion as to who has to disclose its direct or indirect participations in the relevant Swiss listed company, in case of foreign collective investment schemes, the element of control is held to be more crucial.

*By Benjamin Leisinger*

According to article 20 Stock Exchange Act (SESTA), anyone who directly or indirectly (*e.g.* by options or financial instruments) reaches, exceeds or falls short of any of the threshold percentages (3, 5, 10, 15, 20, etc.) listed therein has to report such fact to the respective listed company and the exchange on which it is listed within four trading days after such event. This period starts to run one day after the relevant contract or trade that led to the investor's crossing of the threshold was concluded (the signing, not the closing is decisive and it is not required that a written contract exists, either).

***Normally, the beneficial owner is subject to the duty to disclose.*** However, for collective investment schemes authorized by the Swiss Financial Market Supervisory Authority FINMA (FINMA), certain easements apply. For example, such collective investment schemes do not have to consolidate their positions with other members of the business group or concern if they belong to such a business group or concern.

Also, only the entity holding FINMA's authorization, so-called licensee *(Bewilligungsträger)* has to disclose the holdings—and not the beneficial owners (which would normally be the investors in the Swiss collective investment scheme). The SIX Swiss Exchange's Disclosure Office (Disclosure Office) even offers a specific disclosure form for authorized collective investment schemes meeting the requirements of article 17 of FINMA's ordinance on the Stock Exchange Act (SESTO-FINMA).

Unfortunately, and contrary to the Disclosure Office's valuable comments in the legislative procedure regarding SESTO-FINMA, such ***easements do not apply to foreign collective investment schemes not authorized by FINMA for public distribution in Switzerland,*** unless they provide evidence that they are independent from the other group companies and additionally, and this presents the main problem, this independence is confirmed by the foreign collective investment scheme's competent local supervisory authority.

However, such a confirmation is rarely (if ever) seen in practice. Because of this, foreign collective investment schemes must disclose in a way a normal entity would disclose (if the collective investment scheme is constituted in the form of a legal entity) or the way a normal group of individuals would (if the collective investment scheme is set up in the form of a contractual partnership).

However, because the investors (*i.e.,* shareholders or limited partners) usually do not take and do not influence the investment decisions of the foreign collective investment scheme, the reasoning underlying article 20 SESTA can lead to a disclosure obligation deviating from the one applicable to "normal" entities, nevertheless. ***In certain cases, namely, investors do not have to be disclosed.*** This is due to the fact that the legislative reasons underlying article 20 SESTA, *e.g.* transparency as to the persons or groups of persons potentially influencing the business of the listed company or prevention of surprising unfriendly takeovers, do not mandate that passive investors in collective investment schemes not taking the investment decisions and not exercising voting rights be disclosed. Rather, the general partners or fund management companies and the persons exercising controlling influence on said entities must be disclosed as far as foreign collective investment schemes are concerned. They are the ones taking and/or influencing the investment decisions and/or influencing the exercise of the voting rights associated with the investment in the Swiss listed company.

The situation would be different if one of the investors directly or indirectly holds the shares of the general partner or of the fund management company or offers investment advice to the fund or influences the exercise of voting rights in the Swiss listed company.

In order to find out who is subject to the duty to disclose (as beneficial owner within the meaning of article 20 SESTA as modified for foreign collective investment schemes), in practice, ***the Disclosure Office's Circular III/00 regarding disclosure obligations as a business concern as well as article 10 SESTO-FINMA with respect to acting in concert are to be applied.*** For example, a de facto majority in shareholder meetings, personal interrelations or the right to appoint the majority of the members of the board of directors or contractual arrangements are equally relevant as a majority of the shares in the fund management company would be. This leads to the situation that the general partner or fund management company as well as all their shareholders and persons directly or indirectly exercising controlling influence on these entities must be disclosed as beneficial owners. Here, the Disclosure Offices suggested disclosure form regarding cases of acting in concert or as an organized group (article 10 in connection with article 21 SESTO-FINMA) must be used.

In cases of doubt with respect to the persons subject to the duty to disclose, a foreign collective investment scheme should contact the Disclosure Office and present its constituting documents (articles of association, partnership agreement or similar documents) and the suggested disclosure form or request a recommendation from the Disclosure Office within the meaning of article 20 SESTO-FINMA in due time prior to directly or indirectly acquiring a participation in a Swiss listed company that would trigger a notification obligation.

Hopefully, the Disclosure Office will issue a Circular with respect to the disclosure obligations regarding foreign collective investment schemes not authorized by FINMA in the future. The Disclosure Office's practice, namely, while of course still being based on the individual cases, is consistent and would be worth being put into a Circular in order to reduce the legal uncertainty for foreign collective investment schemes and its fund management companies investing in Swiss listed companies.

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## Proposed New Rules on Stock Exchange Offenses and Market Abuse

Reference: CapLaw-2010-14

In CapLaw-2009-3, we highlighted some of the findings and proposals set forth in the report by the expert commission on stock market offenses and market abuse submitted to the head of the Federal Department of Finance on 29 January 2009. Based on the report, the Federal Council intends to introduce more effective provisions on stock exchange offenses and market abuse. For that purpose, the Federal Council has sent a draft bill for revision of the Stock Exchange Act into consultation until 30 April 2010.

**The draft bill includes proposals for substantive as well as procedural provisions which are aimed to effectively sanction market misconduct in line with international standards.**

*By Petra Ginter*

The draft bill (Draft Bill) of the Federal Council currently under consultation includes, inter alia, the following proposals with respect to a revision of the Stock Exchange Act (SESTA):

## 1) Insider Trading and Market Manipulation

### a) Transfer of Penal Provisions from Penal Code to SESTA

Today, Swiss law strictly distinguishes between ***penal provisions*** addressing and sanctioning stock exchange offenses and ***administrative provisions*** addressing and sanctioning market abuse. As recommended by the expert commission (Commission), the current ***provisions on insider trading and market manipulation*** in the Penal Code (PC) ***shall be transferred to the SESTA.*** Although these provisions have a criminal character, their purpose corresponds with the purposes of the stock exchange law, *i.e.*, to protect the functioning of the capital markets and to provide for a level playing field for investors.

SESTA's scope is essentially limited to provisions for regulated market participants, in particular securities dealers. The Draft Bill proposes to introduce a new draft article 2 (f) SESTA ***defining non-regulated market participants*** (as natural and legal persons that are not subject to article 3 of the Financial Market Supervisory Authority Act (FINMASA)) and a new section 5 (b) SESTA providing rules for ***proceedings against non-regulated market participants*** (see 4 b) below). Accordingly, specific provisions of the SESTA would also apply to non-regulated market participants. This proposal would close the gap in the sense that FINMA could also enforce market abuse (partly or in full) against non-regulated market participants (draft articles 33 (e), 33 (f) and 33 (g) SESTA); whereas today, administrative provisions governing and sanctioning insider trading and market manipulation as well as further abusive behaviors are only applicable to regulated market participants (in particular in FINMA Circular 08/38, as well as FINMASA).

### b) New First Degree Incriminated Conduct

As proposed by the Commission, a new first degree incriminated conduct on insider trading and market manipulation shall be introduced that would ***qualify as crime (Verbrechen)*** if insider trading or market manipulation results in a ***substantial financial profit.*** This characterization as crime would also render (severe) insider trading and market manipulation relevant preceding offenses *(Vortaten)* for money laundering offenses. Further, it would allow to implement the GAFI recommendations and ratify the convention of the European Council.

### c) Revised Provision on Insider Trading (Draft Article 44 (a) SESTA)

- **Expansion of the definition of primary insider:** Under the new law, anyone who has direct access to material, non-public information may qualify as primary insider, *i.e.,* the requirement (under current article 161 (1) PC)) that a person needs to have a privileged position vis-à-vis the company *(Sonderdelikt)* to qualify as primary insider shall be abandoned.

- **Expansion of the object of insider trading:** Securities which are traded on a Swiss stock exchange or derivative instruments that refer to such securities as underlyings (non-standardized OTC products to be included as relevant securities), may qualify as objects of insider trading.

- **Safe harbor clause:** The safe harbor clause proposed by the Commission has also found its way into the Draft Bill. Accordingly, 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 constitute punishable insider trading. This so-called *nobody can be its own insider rule* is widely accepted among Swiss legal scholars and the Commission as well as by the Federal Department of Finance (FDF) held that by expressly including it in the statute, legal certainty would be significantly increased.

- **Compliance with EU law:** Draft article 33 (e) SESTA, prohibiting insider trading for non-regulated market participants, in its proposed form, would cover the same prohibited insider conducts as EU Directive 2003/6/EG (MAD), only that it would not apply to legal persons. Regulated legal persons are, however, subject to FINMA Circular 08/38 and the respective rules of FINMASA.

### d) Unchanged Provision on Market Manipulation (Draft Article 44 (b) SESTA)

- **No expansion of the scope of the provision:** The Draft Bill proposes not to include "real" transactions with a manipulating background to the scope of incriminated market manipulation (current article 161$^{bis}$ PC). "Real" transactions with a manipulating background, such as ramping/camping/pegging, or squeezing/cornering, spoofing, front- and parallel running as well as scalping, are currently included in FINMA Circular 08/38 (see 3 below). This is consistent with MAD according to which the member states are only required to implement administrative sanctions against these transactions.

- **Deletion of the requirement of "unlawfulness" of the profit:** Contrary to current law, the Draft Bill abstains from the requirement of the profit's "unlawfulness" *(Unrechtmässigkeit des Vermögensvorteil)* as such "unlawfulness" test is considered unclear for purposes of Swiss law.

### 2) Duty to Disclosure Shareholdings

The current version of article 20 SESTA setting forth the duty to disclose shareholdings entered into force on 1 December 2007. The latest revision of the provisions on disclosure duties in the FINMA Stock Exchange Ordinance (SESTO-FINMA) was made on 1 January 2009. Compared with international standards, the material content of these rules are comprehensive. Accordingly, a new revision of article 20 SESTA is not planned for the time being.

### 3) Further Prohibited Behaviors of Market Abuse— Linked with the Option of a Limited or Full Market Supervision

As mentioned, "real" transactions with a manipulating background not covered by the provisions on market manipulation in the Draft Bill are currently included in FINMA Circular 08/38. The circular only applies to certain regulated market participants supervised by FINMA. It is generally accepted that these behaviors of market abuse impair the functioning of the capital market, though. To this end, valid reasons speak for a ***prohibited behavior (covering all market abusive behaviors) applicable to all market participants*** (so-called ***Full Market Supervision;*** in German: *allgemeine Finanzmarktaufsicht*) (draft article 33 (g) SESTA-Version A), likely combined with FINMA's competence to determine accepted market practices in order to allow market participants to clearly distinguish between allowed and prohibited behaviors.

The Commission, however, was in favor of the concept of limited market supervision (so-called ***Limited Market Supervision,*** in German: *ergänzte Finanzmarktaufsicht*). Under this concept, ***only certain "real" transactions with a manipulating background*** by non-regulated market participants, *i.e.,* volume manipulation, front- and parallel running as well as scalping, would be prohibited and sanctioned by limited administrative measures under SESTA (draft article 33 (g) SESTA-Version B). This amendment would give FINMA the competence to enforce certain misbehaviors which formally do not qualify as (incriminated) market manipulation. Such concept would not be consistent with the standards contained in the respective European directives. The Federal Council has not taken a final position on this issue yet and the addressees of the consultation paper are asked to express their preference for one or the other option.

### 4) New Procedural Concept

#### a) Centralization of Penal Proceedings

On a procedural level, the goal of the Draft Bill is to ***streamline and centralize the proceedings*** to the largest extent possible. It proposes to assign all penal proceedings with respect to ***stock exchange offenses*** (insider trading (draft article 44 (a) SESTA), market manipulation (draft article 44 (b) SESTA), violation of the duty to disclose shareholdings (draft article 41 SESTA) to the competence of the ***Office of the***

***Attorney General of Switzerland (OAG).*** The ***Federal Criminal Court (FCC)*** would act as first instance having jurisdiction for stock exchange offenses, which could be ***appellated to the Federal Supreme Court.*** Consequently, the stages of appeal could become more efficient and the process of judicial review would be abbreviated compared to existing proceedings. The FDF would no longer be responsible for the prosecution of violations of the duty to disclose shareholdings and the cantonal criminal authorities would no longer be competent for criminal proceedings with respect to insider trading and market manipulation offenses. This concept would help that all penal proceedings with respect to stock exchange offenses would uniformly be governed by the new Federal Code on Criminal Procedure dated 5 October 2007 which is expected to enter into force on 1 January 2011 (StPO) (whereas under current law, different procedural regimes apply).

### b) Competences of FINMA under the Concept of Limited/ Full Market Supervision

In connection with the concept of Limited/Full Market Supervision by FINMA (see 1 a) and 3 above), ***FINMA shall be equipped with efficient and proportionate administrative enforcement tools.*** Proposed new section 5 (b) SESTA, providing an explicit statutory basis for such FINMA competences, would in particular include the following instruments to enforce stock exchange offenses and market abuse against non-regulated market participants: ***The right to issue declaratory orders*** as an instrument to enforce FINMA's own proceedings. This would be in line with current practice afforded to the violation of disclosure duties. Furthermore, FINMA would be authorized ***to impose the disgorgement of profit*** as administrative measure. Hence, FINMA would receive essentially the same administrative enforcement instruments as it already has vis-à-vis regulated market participants (according to FINMASA).

These administrative procedures before FINMA would also be governed by the procedural rules of the Federal Administrative Procedures Act (VwVG) that currently apply to procedures against regulated market participants.

### c) Competences in case of a Violation of Duties to Disclose Shareholdings

The duty to disclose shareholdings currently applies to all, *i.e.,* regulated and non-regulated market participants. In order to provide for a uniform enforcement of the duty (and as it is controversial whether FINMA's administrative instruments provided by the FINMASA are also applicable to enforce the disclosure duty against non-regulated market participants), FINMA shall be equipped, as outlined under 4 b) above, with efficient and proportionate enforcement tools applicable to all market participants.

In addition, the Draft Bill suggests to shift competence for a ***suspension of voting rights*** (in case of a violation of the duty to disclose shareholdings) from the civil courts to ***FINMA*** (draft article 20 (4bis) SESTA). Further, FINMA's right to order a suspension of voting rights for a maximum term of five years shall be supplemented with a ***right to issue an order that prohibits additional acquisitions of securities*** *(Zukaufsverbot)* by the affected person or group of persons for the same period of time. In case of a violation of disclosure duties ***in the context of takeover situations,*** the ***takeover commission*** shall have competence with respect to a suspension of voting rights and a prohibition of additional acquisitions of securities (draft article 32 (7) SESTA).

Under current law, the FDF may impose a ***fine*** on a natural person violating the duty to disclose shareholdings (article 50 (1) FINMASA in connection with articles 20, 31 and 41 SESTA). The Draft Bill proposes to shift competence from the FDF to the ***FCC.*** This change would also have the unifying effect that the StPO would be applied to the procedure (see 4 a) above), instead of the outdated Statute on Administrative Criminal Procedures (VStrR).

**d) Coordination of Penal and Administrative Procedures**

The OAG is not entitled to use findings which FINMA has obtained from the involved parties due to their duty to actively participate in the administrative procedure (*nemo tenetur* principle), but need to investigate the case based on the rules and principals of penal procedure. Therefore, parallel proceedings before the administrative and penal authorities would, in principle, not be a disadvantage. To the contrary, for the involved party and the capital market parallel proceedings would be preferable because the total duration of procedure could be reduced. This requires, however, that FINMA reports an offense, without delay, after having finished its investigations, to the OAG in order for the OAG to open criminal proceedings in due course.

With respect to cases where at the same time FINMA opens administrative proceedings according to draft articles 33 (e), 33 (f) or 33 (g) SESTA against a non-regulated market participant based on its Limited/Full Market Supervision authority and the OAG initiates penal proceedings according to draft articles 44 (a) and 44 (b) SESTA vis-à-vis the same person, such proceedings shall not be enforced simultaneously. In these cases, OAG and FINMA shall coordinate their further actions (based on article 38 (2) FINMASA).

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## Newsflash: New Rule Book for SIX Swiss Exchange

Reference: CapLaw-2010-15

On 1 April 2010, the new Rule Book for market participants will become effective. The current rules and regulations (General Conditions and Directives) have been revised and will be replaced by the new Rule Book.

## A New Take on Liquidity—The Swiss Takeover Board issues a New Circular n° 2 on Liquidity

Reference: CapLaw-2010-16

Whether a security is liquid or not can have far reaching consequences for bidders and shareholders under Swiss takeover regulations. To clarify this issue, the Takeover Board issued a new Circular n° 2, which considers that all securities included in the SLI index and all securities where the median daily volume for ten months out twelve exceed 0.04 percent of the free float are liquid. This article resituates this new rule in its context and analyzes the key drivers of the new definition of liquidity.

*By Rashid Bahar*

### 1) Hard Cases Make Bad Law

Whether a security is liquid or not can have far reaching consequences for bidders and shareholders under Swiss takeover regulations. Indeed, if a security is deemed to be liquid, the minimum price for a mandatory bid will be at least the stock exchange price at the time of the offering (article 40 (1) SESTO-FINMA), which is defined as the volume weighted average price (VWAP) of the 60 trading days that preceded the publication of the offering prospectus or the prior announcement (article 40 (2) SESTO-FINMA). By contrast, if the security is deemed not to be liquid, the minimum price will be based on a valuation of the security by the review body appointed by the bidder to examine the offer (article 40 (2) SESTO-FINMA). As several precedents pointed out, to be liquid or not can prove to have a significant impact on the minimum price to the advantage of the bidder or of the shareholders who received the tender offer (Comp. Decision of FINMA of the 6 April 2009 in the matter of Harwanne Compagnie de participations financières et industrielles and Recommandation 0251/03 – Aare-Tessin AG für Elektrizität of 19 January 2006).

Yet, what makes a security liquid or not? For a long time, the Swiss Takeover Board was content with a workaday definition of liquidity: It considered that a security was deemed to be liquid if it was traded over more than half of the relevant period for determining the VWAP, namely over more than 30 days under the current regulations,

which provide for a 60 trading day VWAP (Communication n° 2 of the Takeover Board of 3 September 2007).

Last year, however, the *Harwanne* takeover tested the limits of the simple definition called for by the 30/60 rule described above. The facts of the case compelled the Takeover Board to rely on the escape clause it had added to the workaday definition and consider that, although *Harwanne* securities satisfied the formal criterion of the 30/60 rule, they were not liquid. Following this decision, complex litigation and appellate proceedings, involving the bidder, two minority shareholders, the company and the regulators, ensued. On appeal, FINMA, acting as the appellate body for takeover decisions, affirmed the decision of the Takeover Board. This decision was then appealed by the bidder, who eventually, after having bought out the minority shareholders, withdrew the appeal. Although justice was done in the case at hand, the limitations of the workaday definition were brought to light and the definition of liquidity needed to be revisited, as the definition of liquidity no longer guaranteed legal certainty or simplicity.

### 2) Circular n° 2—A new Definition of Liquidity

Following the *Harwanne* case, the Takeover Board reviewed the merits of the 30/60 rule and, eventually, issued on 26 February 2010 a new Circular n° 2—Liquidity in the Context of Takeover Law, which will apply to all new tender offers published after 31 March 2010.

This new definition of liquidity was decided by the Takeover Board on the basis of a report of an external consultant (available at http://www.takeover.ch/public/data/documents/report_zur_publikation.pdf) without any general consultation or hearing. This regulatory process is in line with the genesis of the previous Communication n° 2, which was also adopted without any public consultation and codified a longstanding practice of the Takeover Board. Nevertheless, this approach departs from other instances of informal rulemaking by the Takeover Board, which were preceded by a consultation process and, more importantly, from the Guidelines for Financial Regulation issued by the Federal Department of Finance as a guidance to all regulatory bodies involved in formal and informal rulemaking in the financial sector, which calls for an open and transparent rulemaking (see Federal Department of Finance, *Richtlinien für Finanzmarktregulierung,* Bern 2005, Item 8). However, the lack of any consultation process does not bear any legal consequence as to the validity of Circular n° 2.

As to its substance, Circular n° 2 adopts a two tiered approach: first, it posits that all securities included in the SLI index are liquid, thus ensuring that in any event the minimum price for bids on Swiss blue chips will be based on the market value. For all the other securities, instead of the simple definition relying on the number of days on which a security was traded, the new definition considers that a security is liquid, if, on at least ten of the twelve full calendar months preceding the publication of the tender

offer prospectus or the preliminary announcement, the monthly median daily volume equaled or exceeded 0.04% of the free float of the security. In spite of its seemingly complex definition, this indicator is relatively simple to compute using publicly available data, namely the daily volumes and the free float of the security. The first step consists in dividing each daily volume by the free float. Based on this data, the median (and not the average) daily volume for the twelve full calendar months preceding the publication of the offer can be easily determined. Then, if on ten out of twelve months, the median daily volume exceeded 0.04% of the free float, the security is deemed to be liquid. Unlike the previous definition of liquidity, Circular n° 2 does not provide for an escape clause allowing the Takeover Board to reconsider the definition of liquidity on a case by case, if the circumstances call for such an inquiry, thus offering at least at face value, a higher degree of legal certainty.

Circular n° 2 measures liquidity using a trading activity indicator: a security is deemed to be liquid, if on the median day of ten out of twelve months, the daily volume is significant in comparison with the free float. This indicator captures liquidity in terms of the ease a market participant has to sell or buy a security at short notice and the capacity of the market to absorb large orders. By contrast, Circular n° 2 eschews other indicators of liquidity that focus on the bid-ask spread and the impact of large orders on the price. While this choice is probably driven by practicability concerns and seeks to use a relatively simple indicator of liquidity, which all market participants can easily compute, it neglects the most important role of liquidity in the context of takeover law: the guarantee that the market price constitutes a fair benchmark to set the minimum price for a mandatory bid.

In spite of this shortcoming, this definition of liquidity is reasonable and, to a large extent, tamper-proof: the use of a relatively long observation period of twelve months and the focus on the monthly median daily volume—and not the average daily volume—makes it difficult to manipulate the data and insulate the test from the impact of large swings and outliers. Similarly, the calibration of the percentage at 0.04% for ten out of twelve months allows an overwhelming percentage of the volume and market capitalization of SIX Swiss Exchange to be deemed liquid (99.75 percent of the aggregate volume and 97.5 percent of the total market capitalization). Nevertheless, under this criterion, hardly more than half the securities traded on SIX Swiss Exchange pass the muster. While this implies that valuations will be the rule for bids on small and mid caps under the new Circular n° 2, the outcome is not shocking: it is indeed no secret that liquidity on the SIX Swiss Exchange is concentrated among the largest blue chips, leaving most mid- and small-caps without any actual trading.

### 3) Impact of the Definition of Daily Volume and Free Float on Liquidity

As with any new rule, Circular n° 2 yields its load of uncertainties: the liquidity of a security under the new definition therefore depends on two operational variables: (a) the free float and (b) daily volumes. Although the data is readily available from SIX Swiss Exchange for securities traded on that exchange and the liquidity of a security could be easily computed on this basis, a closer look into the definition of these variables provides some additional insight as to the impact of the new definition.

The daily volume is determined on the basis of the trades carried out on the trading line on a given exchange day, thus excluding any off-order book trading. If a security is traded on several traded lines or on several exchanges, the volumes are added up together, thus potentially turning a security that would be illiquid if only volumes traded on the local market were considered into a liquid security. By contrast if a given issuer has several classes of equity security outstanding, it is not possible to add up volumes across classes. In any event, this definition of the daily volume is fairly uncontroversial: it fulfills the goal of the liquidity indicator for takeover law. Indeed, by considering only trades carried out on the exchange, it constitutes a good proxy to measure whether the exchange price adequately reflects the assessment of the market on the value of the share. Moreover, as mentioned above, the reliance on median values also makes this variable relatively tamper-proof.

The definition of the free float is by contrast more likely to lead to controversies in borderline cases. According to Circular n° 2, where the security is listed on the SIX Swiss Exchange, the free float is defined in accordance with the definition used by the Swiss All Shares Index Rules (www.six-swiss-exchange.com/index_info/online/other_indices/swiss_all_share/swiss_all_share_rules_en.pdf). If the security is listed on another exchange, the definition of the free float applicable on such exchange apply, and wanting any such definition, the security is deemed to have a free float of 100%. On a side note, the relevant measure of the free float is the number of shares included the free float and not the percentage of the outstanding shares included free float as the language of Circular n° 2 seems to suggest (cf. *"fraction librement négociable"; "handelbare Teil"*).

This seemingly straightforward definition conceals certain biases of the index rules and, in particular, SIX All Shares Index Rules, which will apply in most cases. Indeed, under these index rules, the free float is calculated on the basis of the issued and outstanding shares listed in the commercial register minus all shareholdings of persons holding more than 5 percent. However, to determine whether a shareholder holds a substantial shareholding, the SIX All Shares Index Rules does not have a direct access to the shareholdings of investors but has to turn to the rules on disclosure of substantial shareholdings under article 20 SESTA and consider disclosures as completed by other sources of information.

At the same time, the SIX All Shares Index Rules enables SIX Swiss Exchange to count the holdings of certain intermediaries and institutional investors—custodian nominees, trustee companies, investment funds, investment companies, and pension funds—as a part of the free-float, even when the position held by such intermediaries exceeds 5%. Thus, investment vehicles and intermediaries other than banks, securities dealers and insurance companies will be included in the free float even if they have a buy and hold strategy and do not actively trade the shares included in their position. The impact of this exception is to increase the free float and make it all the more difficult for thinly traded shares to qualify as liquid, if institutional investors hold a substantial position in them.

Finally, the Circular n° 2 does not clearly determine when the relevant free float should be calculated, namely at the time of the offering or the free float that was available on a given month. This gap may have far reaching consequences in the event of a mandatory bid as one may expect that as a potential bidder builds up his stake, the free float will be consequently reduced. If the free float at the time of the publication of the tender offer prospectus or the preliminary announcement is used, a smaller daily volume will be needed to reach the threshold of liquidity set at a median daily volume of 0.04% of the free float. This will push more securities into the realm of liquidity than if historical values were used, even assuming that volumes are held constant over the observation period. At the same time, simply using historical SIX Swiss Exchange data, as the export report backing the circular seems to suggest, is not fool proof either. Indeed, it may encourage potential bidders to build a stake thus reducing the free float and then wait before crossing the threshold for a mandatory bid or presenting a tender offer if it is in their interest to have a liquid security.

These three issues in connection with the computation of the free float raise in turn a new question: how will the Takeover Board and FINMA, in its capacity as appellate body, handle any challenge to the data provided by SIX Swiss Exchange: Will they defer to the judgment of SIX Swiss Exchange or will they revisit this decision and underlying policy choices? The former solution, which ought to prevail, guarantees legal certainty and transparency for prospective bidders and investors, but lets the index provider who has other concerns than a regulator adjudicate this potentially highly contentious issue.

Overall, the new Circular n° 2 offers more robust criteria to determine whether a security is liquid or not than the one prevailing until now. This new definition is thus undoubtedly more complex than the 30/60 rule applied until now. Nevertheless, while the new definition is clearly less prone to manipulation than its predecessor, a bidder can try to play with the definition of the free float to ensure that the security falls on the most advantageous side, liquid if it wants to avoid a valuation and illiquid if it wants a valuation. At the same time the new rule offers the promise of more legal certainty: the criteria are clear and although a substantial proportion of the categories of shares

listed on the SIX Swiss Exchange will be subject to a valuation process, bidders and investors alike will be in a position to know in advance whether a given share is liquid or not, which is a virtue in itself.

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## Potential Offerors to "Put up or Shut up"

Reference: CapLaw-2010-17

As part of the amendments to the Takeover Ordinance, on 1 January 2009 new article 53 of the Takeover Ordinance became effective which allows the Takeover Board to set a potential offeror a deadline to *put up or shut up*. This article discusses the new rule and compares it to the put up or shut up regime under the UK City Code on Takeovers and Mergers, which served as a model.

*By Daniel Bono*

### 1) Introduction

Potential offerors have increasingly made what has become known as ***virtual offers,*** where a potential offeror announces that it is considering making an offer for a target company without committing itself by launching a formal offer. Given the increased difficulty to secure financing for a takeover offer, the number of virtual offers will likely further rise. Such virtual offers may besiege target companies for an extended period of time, with potentially destabilizing consequences.

To allow the Swiss Takeover Board (TOB) to deal more effectively with virtual offers, the amendments to the Takeover Ordinance (TOO) which became effective on 1 January 2009 include new article 53 which allows the TOB to force the hand of a virtual offeror by setting a deadline to either ***put up*** by making a formal offer or ***shut up*** by confirming that it will refrain from launching a takeover offer (or take any action that would trigger a mandatory offer) for a period of six months.

This article discusses the put up or shut up rule and compares it to the put up or shut up regime under the UK City Code on Takeovers and Mergers (Code), which served as a model.

### 2) Regulatory Context

From the point of view of the potential offeror, a virtual offer has advantages over making a formal offer. It puts pressure on the management of the target company and allows the potential offeror to test the markets without having to follow the detailed rules governing formal offers.

From the point of view of the target company, however, being put *in play* by a virtual offer—in particular a hostile one—may have destabilizing consequences. Substantial management resources may have to be allocated to addressing the offer and the increased uncertainty about a company's future may have a negative effect on relations with employees, suppliers and customers. In addition, shareholders with short-term profit goals may increase their holdings in the target company, thereby further increasing pressure on management. In addition, a virtual offer may also lead to increased and undesirable levels of uncertainty in the markets. Generally, a virtual offer puts the target company under similar pressure as a formal offer without affording it the protections of the detailed rules governing formal offers.

Prior to the amendment of the takeover rules, when faced with a virtual offer, the TOB had only two choices: To qualify the virtual offer as a formal pre-announcement of a takeover offer (despite the lack of certain formal requirements) or not to intervene at all. The former could have severe consequences for a potential offeror, the latter could expose the target company to the negative effects of a virtual offer.

### 3) Article 53 TOO

Article 53 TOO provides the TOB with a tool to deal more effectively with virtual offers. Pursuant to article 53 TOO, the TOB may issue a put up or shut up order once a potential offeror publicly announces that it is considering launching a takeover offer. The put up or shut up order imposes a deadline on the potential offeror to either make a formal offer or publicly declare that it will not launch a takeover offer (or take any action that would trigger an obligation to make a mandatory offer) for a period of six months. Article 53 TOO also states that the TOB may waive the six-month block-out period under certain circumstances, for example if a third party makes an offer for the target company.

Pursuant to article 53 TOO, the TOB is only authorized to issue a put up or shut up order if the potential offeror itself publicly announces that it is considering launching a takeover offer, even though virtual offers may have negative consequences for a target company prior to such public announcement by the offeror (*e.g.,* share price movements due to market rumors). Given these limitations, it will be interesting to see how the TOB will react to a situation where the potential offeror does not make a public announcement and, for example, the target company makes a public announcement that it has been approached by a potential offeror.

If a potential offeror fails to comply with the put up or shut up order, any subsequent formal offer made by such offeror will be deemed formally pre-filed at the time the offeror made the virtual offer, if this conclusion benefits the shareholders of the target company. The main implication of this look-back provision is that the *best price rule* and the *minimum price rule* would apply from the date of the first public announcement.

### 4) Rule 2.4(b) of the Code as a Model

The put up or shut up concept has been applied by the UK Takeover Panel (the regulatory body responsible for supervising takeovers in the UK) for a number of years and has been codified in the Code for the first time in 2004 as Rule 2.4(b). It reflects the general principle of the Code that *an offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.*

Pursuant to Rule 2.4(b), the Panel may—upon request by the target company—set a potential offeror a deadline to announce an offer, or to announce its intention not to make an offer in which case the potential offeror is barred from making any offer for a period of six months (or until the Panel waives the block-out period). Because the UK put up or shut up regime is based on longstanding Panel practice, it is more detailed than the TOO. The following practice of the Panel under the Code may be of interest for the application of article 53 TOO:

- The normal put up or shut up deadline given by the Panel is six to eight weeks (if the request is issued early in the process);
- the six months block-out period may also be waived if the target company's board recommends the blocked-out offer (provided that a corresponding reservation has been made in the public statement of no intention to make an offer); and
- the Panel may take the view that a simple denial of speculation by a potential offeror as to its intention to make a bid (such as informal or private comments that subsequently get publicly reported) can be considered a *no intention to bid* statement and may trigger a six-month block-out period.

### 5) Key Difference Between the UK and the Swiss Put Up or Shut Up Regime

A key difference between the UK and the Swiss regime is that under the Code, the Panel may only issue a put up or shut up order upon request from a target company, while the TOO authorizes the TOB to issue a put up or shut up order, whether or not requested by the target company to do so.

Therefore, while the UK put up or shut up regime seems to focus mainly on providing an effective defensive weapon to a besieged company that is hindered in the conduct of its business by a virtual offer, the Swiss put up or shut up regime also hands a tool to the TOB to protect the markets from the negative effects of a potential offer. However, this may put the TOB in a difficult position. Knowing when to issue a put up or shut up order requires business judgment—too soon and shareholders may miss an attractive offer; too late and a target company could be damaged following an extended period of uncertainty.

### 6) Outlook

To date, there has not been any case under article 53 TOO. In the absence of a long-standing practice, it is likely that the TOB will look to the Panel's practice when interpreting article 53 TOO. Regulatory developments, such as the recent announcement of the Panel of a consultation on the rules governing hostile takeover bids (which include the put up or shut up regime) may therefore be of interest for legal developments in Switzerland and should be closely watched.

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## New SEC Guidance on Climate Change Disclosure – Relevant for Swiss Issuers?

Reference: CapLaw-2010-18

The U.S. Securities and Exchange Commission (SEC) has provided interpretive guidance to public companies regarding existing U.S. disclosure requirements as they apply to climate change. The new SEC guidance is directly applicable only to "SEC registrants" and to disclosure documents filed with the SEC. Increased SEC emphasis on climate change disclosures, however, may also increase the extent of climate change disclosure in offering documents not filed with the SEC, in particular in so-called "Rule 144A offerings" that are also directed at U.S. investors. In addition, most of the U.S. disclosure rules highlighted in the new SEC guidance have parallels in other jurisdictions, including Switzerland.

As a result, certain public companies that are not SEC registrants may also want to consider reviewing their public disclosures to assess the extent to which they address material risks and other matters discussed in the new SEC guidance.

*By Bernd Bohr / Stefan Sulzer*

At an open meeting on January 27, 2010, the SEC decided in a party-line, 3-2 vote to provide SEC-registered public companies with interpretive guidance on existing SEC disclosure requirements as they apply to business or legal developments relating to the issue of climate change. The full text of the new guidance is available on the SEC's Web site at: http://sec.gov/rules/interp/2010/33-9106.pdf

The decision to publish the new guidance did not come as a surprise to most U.S. securities law practitioners, as it followed growing pressure from various environmental and investor groups as well as politicians over the last few years for the SEC to do more in this area. In the new guidance, the SEC notes that climate change has become a topic of intense public discussion in recent years, that a number of state and local governments in the U.S. have already enacted legislation and regulations that result in greater

regulation of greenhouse gas emissions and that climate change-related legislation is currently pending in the U.S. Congress, while the United States Environmental Protection Agency (EPA) has been taking steps to regulate greenhouse gas emissions.

### 1) Scope of Application of the new SEC Guidance

While the new SEC guidance emphasizes that it does not purport to create new disclosure requirements, it outlines the SEC's views with respect to its existing disclosure requirements as they apply to climate change matters. It is directly applicable only to "SEC registrants", i.e. companies that have securities registered under the U.S. Securities Exchange Act of 1934, as amended (the Exchange Act), and to disclosure documents filed with the SEC.

However, organizations such as the World Business Council for Sustainable Development and the Coalition for Environmentally Responsible Economies have been active in initiating international corporate sustainability reporting. In addition, the Global Reporting Initiative has worked with industry groups to develop guidelines for reporting on sustainability. Most of the rules highlighted in the new SEC guidance also have parallels in other jurisdictions, including Switzerland.

As a result, many companies have been making disclosures about environmental sustainability in their annual reports or in separate environmental sustainability reports for some time. Those companies would be well advised to review their disclosures to assess the extent to which they address material risks and other matters discussed in the new SEC guidance.

### 2) U.S. Disclosure Rule

The U.S. federal securities laws and existing SEC regulations have long contained a number of general disclosure rules that may require SEC registrants to address their exposure to environmental and climate change-related developments, if material.

#### a) U.S. Domestic Issuers

For U.S. domestic issuers that file disclosure documents with the SEC, the requisite form will largely refer to the disclosure requirements of Regulation S-K. The most relevant items of Regulation S-K cover a company's risk factors, business description, legal proceedings, and management's discussion and analysis (MD&A). In addition to these specific disclosure requirements, Rule 408 under the U.S. Securities Act of 1933, as amended (the Securities Act) and Exchange Act Rule 12b-20 generally require disclosure of "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."

### b) Foreign Private Issuers

The SEC disclosure obligations of so-called "foreign private issuers" (i.e., non-U.S. companies that are required to file reports with the SEC) are principally based on the requirements of Form 20-F, rather than those in Regulation S-K. The new SEC guidance, however, stresses that many of the relevant items of Regulation S-K have parallels in Form 20-F, including (i) risk factors (Item 3.D); (ii) material effects of regulation on the registrant's business (Item 4.B.8); (iii) effects of environmental issues on utilization of the registrant's assets (Item 4.D); (iv) explanation and management's assessment of factors and trends that affect the registrant's financial condition and results (Item 5); and (v) material legal proceedings (Item 8.A.7).

Swiss "foreign private issuers" that are required to file annual reports on Form 20-F with the SEC include ABB Ltd., Credit Suisse, Novartis AG, Syngenta AG and UBS AG.

### c) Exempt Offerings to U.S. Investors—Rule 144A

The U.S. securities laws contain certain exemptions that permit offers and sales of securities to U.S. investors without SEC registration and without incurring ongoing SEC reporting obligations. One frequently used exemption are offerings to so-called "Qualified Institutional Buyers (QIBs)" in the U.S. pursuant to Securities Act Rule 144A. Because such offerings are still subject to potential liability for material misstatements or omissions under the general anti-fraud provisions of Exchange Act Rule 10b-5, Rule 144A offering documents are typically prepared to meet very similar disclosure standards as offering documents filed with the SEC. Issuers and underwriters in Rule 144A offerings are therefore well advised to ensure that the relevant offering documents adequately reflect any material risks and other matters covered by the new SEC guidance.

## 3) Swiss Disclosure Rules

Many of the U.S. disclosures rules highlighted in the new SEC guidance have parallels in Switzerland which may similarly require Swiss listed companies to address their exposure to environmental and climate change-related developments. Article 28 of the Listing Rules *(Kotierungsreglement)* of the SIX Swiss Exchange, for example, provides that listing prospectuses for equity securities must contain the information prescribed in Scheme A—Equity Securities (Schema A—Beteiligungsrechte). The relevant items of Scheme A include risk factors *(Risikofaktoren)*, business activities *(Geschäftstätigkeit)* and investments *(Investitionen)*.

### a) Risk Factors

Item 1 of Scheme A requires issuers to provide a presentation of the risk factors that are key in assessing the market risk attached to the issuer, its sector and the securities being offered and/or to be admitted to trading. If those key risks include significant

climate risks, issuers should clearly state those risks and specify how they affect the particular issuer.

#### b) Business Activities

Item 2.3 of Scheme A requires issuers to provide information on certain enumerated business activities which are material in assessing the issuer's business activities and earning power. The required disclosure includes a description of the issuer's principal activities and of any research and development (R&D) projects initiated and concluded in the last three years. To the extent these activities have been influenced by developments or considerations related to climate change, this may have to be disclosed. Item 2.3 also requires disclosure of any material pending or threatened legal proceedings. Again, to the extent this includes material environmental proceedings, this must be disclosed.

#### c) Investments

Item 2.4 of Scheme A finally requires issuers to (i) provide figures on the principal investments made during the period covered by the historical financial information included in the prospectus, (ii) disclose their principal current investments and (iii) disclose their principal future investments for which legally binding undertakings have been entered into. This, for example, may require an issuer to disclose its costs and related investments to ensure compliance with environmental regulation, either in Switzerland or abroad.

### 4) EU Disclosure Rules

Swiss issuers that are listed on an EU regulated market are subject to EU Prospectus Directive general rules that are also similar to the relevant U.S. disclosure rules and are required to disclose relevant risk factors or trends and to comment on the future prospects of the business, which may include material effects of environmental legislation, such as the EU Emissions Trading Directive.

### 5) Climate Change-Related Disclosures

The new SEC guidance highlights the following areas as examples of where climate change may trigger disclosure requirements. Many of these examples may be equally relevant for Swiss issuers that are affected by developments related to climate change.

#### a) Impact of Legislation and Regulation

Issuers should consider whether the impact of certain existing laws and regulations regarding climate change is material (i.e., whether any climate change legislation is reasonably likely to have a material effect on the registrant's financial condition or results of operation) and, in certain circumstances, should also evaluate the potential impact

of pending legislation and regulation. The new SEC guidance stresses that SEC registrants should not limit their evaluation of disclosure of legislation only to the negative consequences, as change in the law or resulting changes in business practices may also provide new opportunities.

Possible consequences, for example, of the adoption of a "cap and trade"-type system for greenhouse gas emissions include expenditures required to purchase, or profits from sales of, allowances or credits; expenditures required to comply with limits on emissions; and changes to profit or loss arising from increased or decreased demand for goods and services due to regulation, or from changes in costs of goods sold.

**b) Impact of International Accords**

Similarly, issuers should also consider, and disclose when material, the risks or effects on their business of international climate change accords and treaties.

This is particularly true for issuers with international operations and not limited to accords or treaties that apply in the issuer's home jurisdiction. Unlike Switzerland, for example, the United States has never ratified the 1997 Kyoto Protocol, but the new SEC guidance specifically notes that operations outside of the United States may still be subject to its standards or to the standards of other international regulatory systems, such as the EU Emissions Trading Directive. Ongoing international discussions at the state level, including the recent United Nations Climate Conference in Copenhagen, may lead to further international treaties focused on remedying environmental damage caused by greenhouse gas emissions.

**c) Indirect Consequences of Regulation or Business Trends**

Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for issuers. For example, an issuer may face decreased demand for goods that produce significant greenhouse gas emissions or increased demand for goods that result in lower emissions than competing products. There may be increased competition to develop innovative new products, increased demand for generation and transmission of energy from alternative energy sources or decreased demand for services related to carbon based energy sources, such as drilling services or equipment maintenance services. These business trends or risks may be required to be disclosed as risk factors or, in the case of SEC registrants, in MD&A, and, in some cases, these developments could have a significant enough impact on an issuer's business that disclosure may be required in its business description and the description of its investment activities. For example, material investments to take advantage of business opportunities may require disclosure as part of the issuer's business description, while the potential impact of regulation or business trends may require risk factor disclosure.

### d) Physical Impacts of Climate Change

Issuers with businesses vulnerable to severe weather or climate-related events should consider whether the physical effects of climate change, such as severe weather (for example, floods or hurricanes), sea levels, arability of farmland, and water availability and quality, may potentially affect the issuer's operations and results and therefore require disclosure. Possible consequences of severe weather could include indirect financial and operational impacts from disruptions to the operations of major customers or suppliers, increased insurance claims and liabilities for insurance and reinsurance companies and increased insurance premiums and deductibles, or a decrease in the availability of coverage, for issuers with plants or operations in areas subject to severe weather.

Climate change can decrease demand for products or services; for example, warmer temperatures could reduce demand for residential and commercial heating fuels, service and equipment.

## 6) Conclusion

While the new SEC guidance emphasizes that it does not purport to create new disclosure requirements, it outlines the SEC's views with respect to its existing disclosure requirements as they apply to climate change matters.

The new SEC guidance is directly applicable only to "SEC registrants" and to disclosure documents filed with the SEC. Increased SEC emphasis on climate change disclosures, however, may also increase the extent of climate change disclosure in offering documents not filed with the SEC, in particular in "Rule 144A offerings" that are also directed at U.S. investors. In addition, most of the U.S. disclosure rules highlighted in the new SEC guidance have parallels in other jurisdictions, including Switzerland.

As a result, certain public companies that are not SEC registrants may also want to consider reviewing their disclosures to assess whether they address material risks and other matters discussed in the new SEC guidance. It is particularly relevant for companies that are active in, dependent on or linked to industries that are the most likely to be affected by climate change and related regulations, such as the power industry, the coal, oil & gas and alternative energy industries, the transportation industry, the financial services industry and the agriculture industry.

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# Securities Lending and Borrowing in Light of FINMA Circular 10/2

Reference: CapLaw-2010-19

FINMA Circular 10/2 regarding Repo- and Securities Lending Transactions (the "SLB Circular") will enter into force on 30 June 2010. The SLB Circular regulates certain aspects of securities lending and borrowing transactions ("SLB Transactions") entered into by banks and securities dealers with customers and specifies how Repo- and SLB Transactions are to be accounted for under the liquidity requirements of article 16 et seq. of the Banking Ordinance. This article discusses the impact of the regulation of SLB Transactions under the SLB Circular but does not analyse the treatment of Repo- and SLB Transactions under liquidity rules.

*By Olivier Favre*

## 1) When is the SLB Circular applicable?

The SLB Circular will apply to institutions licensed either as banks under the Banking Act or as securities dealers under the Stock Exchange and Securities Trading Act. The SLB Circular regulates certain aspects of SLB Transactions in Part II, which will apply if the bank or securities dealer borrows securities from a customer. For the purposes of the SLB Circular, a "customer" is any counterparty to an SLB Transaction other than a bank, a securities dealer, a fund management company *(Fondsleitung)* or an insurance company (SLB Circular, note 2). Counterparties in respect of which the SLB Circular will apply will therefore not only include individuals but also certain institutional investors such as pension funds (see the FINMA Report of 17 December 2009 regarding the consultation with respect to the draft SLB Circular (the "FINMA Report"), page 5). With respect to collective investment schemes, the wording of the SLB Circular only carves-out from its scope of application transactions entered into with fund management companies *(Fondsleitungen)* (which would be the case for contractual collective investment schemes). However, transactions entered into directly with a fund (such as a SICAV, regardless of whether or not a fund management company acts as agent on its behalf) would fall under the SLB Circular. Thus, where the counterparty to the SLB Transaction does not qualify as a "customer", the requirements of Part II of the SLB Circular (set out below under 2) will not apply.

Whether the lender is domiciled outside of Switzerland will not matter with respect to the scope of application of the SLB Circular. However, the SLB Circular will not apply to securities lending arrangements entered into with borrowers domiciled outside of Switzerland where the only nexus to Switzerland is the involvement of a Swiss bank as custodian (see the FINMA Report, page 5).

SLB Transactions may be structured in different ways. The borrowing bank or securities dealer may enter into a SLB Transaction either as principal in its own name or as

agent in the name, and for the account, of another party. SLB Transactions may concern a single securities loan or the lender and the borrower may enter into a securities lending program (a master agreement) under which multiple securities loans may be entered into as and when such securities lending is requested. Where the borrower provides collateral to the lender to secure the borrower's obligation to return the same amount of securities of the same kind, such master agreement can document not only the securities loans but also the security arrangement. The master agreement may include provisions regulating how the borrower's obligation to return the borrowed securities are netted against the lender's obligation to return the collateral upon the occurrence of certain events.

The SLB Circular will be applicable to all such forms of securities lending mentioned in the previous paragraph provided that the bank or securities dealer borrows securities from the customer. By specifying in Part II of the SLB Circular that it applies to transactions where the bank or securities dealer borrows securities from the customer, FINMA implicitly specifies that such rules will not be relevant for transactions where the bank or securities dealer only lends securities to the customer.

## 2) Requirements under Part II of the SLB Circular

### a) Providing Collateral to Retail Customers

A new requirement introduced by the SLB Circular is that banks and securities dealers must collateralise fully all SLB Transactions entered into with retail customers. The SLB Circular specifies that qualified investors within the meaning of art. 10(3) of the Collective Investment Schemes Act (CISA) will be deemed not to be "retail customers". With such cross-reference to CISA, the following types of counterparties falling within the scope of the SLB Circular are exempted from the collateralisation requirement: (i) pension funds with professional treasury functions; (ii) corporations with professional treasury functions; (iii) individuals with financial investments worth at least CHF 2 million (on a net basis); and (iv) counterparties that have entered into a written asset management contract with a supervised financial intermediary pursuant to article 10 (3) (a) CISA (i.e. a bank, securities dealer or fund management company). Counterparties that did not enter into such asset management contract with a supervised financial intermediary (but, for instance, with an independent financial advisor) may be qualified investors under CISA (on the basis of article 6 (2) of the Collective Investment Schemes Ordinance (CISO) and article 10 (4) CISA), but SLB Transactions with such counterparties are not exempted from the collateralisation requirement under the SLB Circular (see the FINMA Report, page 7). Where, however, an individual has entered into a written asset management contract with a bank in addition to the SLB Transaction, the cross-reference to article 10 (3) CISA leads to the result that no collateral has to be provided for the SLB Transaction.

#### b) Contracts documenting SLB Transactions

SLB Transactions falling within the scope of the SLB Circular must be documented in a contract that is legally binding and enforceable. Such contract has to meet certain minimum requirements: (i) it must allow the customer to exclude certain securities from the securities lending; (ii) it must address how the customer will be compensated for securities that are redeemed or in respect of which payments are made while they are borrowed; (iii) it must include the method how the lending fee to be paid to the customer for entering into the securities lending arrangement is calculated; (iv) it must allow the customer to terminate both individual securities loans and the master agreement entered into between the parties at any time without the need to give prior notice (except that individual securities loans entered into for a fixed term are terminated upon expiry of such fixed term); and (v) it must specify on what terms and conditions the securities are transferred back to the customer upon termination of a securities loan.

The SLB Circular also specifies that the customer must agree to enter into the SLB Transactions in a contract other than the general terms and conditions of the bank or the securities dealer. The SLB Circular allows the bank or securities dealer to combine the contract documenting the SLB Transactions with another agreement signed by the customer, as long as it is separate from the general terms and conditions. This customer consent requirement is in line with article 22 (2) of the Book-Entry Securities Act (BESA), which specifies the consent requirements regarding the custodian's right to use the securities it holds for depositors and the FINMA practice pre-BESA (see the Annual Report 2002 of the Swiss Federal Banking Commission, p. 47 et seq.). The scope of application of the consent requirement under BESA is, however, not identical with the scope of application of the consent requirement under the SLB Circular. Article 22 (2) BESA carves-out "qualified investors" within the meaning of article 5 (d) BESA (including custodians, insurance companies, public-law entities, pension funds and corporations with professional treasury functions) from the written consent requirement. Some of such "qualified investors" are "customers" for the purposes of the SLB Circular (e.g. pension funds and corporations with professional treasury functions) and are therefore subject to the consent requirements of the SLB Circular.

#### c) Disclosure Requirements

The SLB Circular requires that the bank or securities dealer informs the customer about the risks resulting from the SLB Transaction (either in the contract documenting the SLB Transactions or another contract such as an asset management contract, provided that the disclosure is not made in general terms and conditions). The disclosure has to include in particular the following: (i) whether the bank or securities dealer enters into the SLB Transaction as a principal or as an agent acting for a third party and, if the latter is the case and the SLB Transaction is not collateralised, whether the bank or

securities dealer is guaranteeing the obligations of the principal to return the borrowed securities; (ii) that the customer loses his entitlement to or his ownership of the borrowed securities and only has a claim to receive back the same amount of securities of the same kind; (iii) that such claim does not grant a right to set-aside the borrowed securities in the insolvency of the borrower *(Absonderungsrecht);* (iv) except where collateral has been provided, that the customer's claim arising from the SLB Transaction is limited to a contractual claim which is not ranking senior to other unsecured creditors in the borrower's insolvency and does not give the customer any benefits from depositor protection schemes *(Einlagensicherung);* (v) that the rights resulting from the borrowed securities, such as voting rights, are transferred to the borrower in the absence of any other arrangements between the parties to the SLB Transaction; and (vi) that the risks of any loss in value of the borrowed securities (market risk) remains with the lender.

**d) Accounting for Fees and Compensation**

The SLB Circular specifies that the borrower must calculate and pay periodically to the lender any lending/borrowing fees and compensation payments (e.g. as a result of redemptions or other payments made while the securities are borrowed). While such compensation payments may be paid as and when the borrower receives the relevant payments, the requirement to account for them periodically is intended to be a minimum requirement (see the FINMA Report, page 8). The borrower must also provide to the lender the relevant information about the fees and compensation payments that have accrued in such period.

**e) Securities Account Statement**

The SLB Circular provides that the securities account statement has to specify that the lender participates in a securities lending program (regardless of whether or not securities are borrowed). Moreover, when securities are borrowed, the securities account statement must specify which securities have been borrowed.

Securities held through Swiss custodians within the meaning of BESA will qualify as book-entry securities under BESA. Accordingly, such book-entry securities will be transferred to the borrower's securities account under article 24 BESA and the lender loses his entitlement in the borrowed securities. The securities will remain registered on the lender's securities account (unlike a transfer for other reasons) but they will be earmarked as "borrowed". Such earmark ensures visibility of the fact that the securities have been transferred to the borrower and are subject to the securities lending and borrowing arrangement.

#### f) Registration with the Issuer

The SLB Circular provides that the bank or securities dealer must register the transfer of borrowed shares after completion of each SLB Transaction with the relevant shareholders' register (for registered shares of Swiss stock companies, the *"Aktienbuch"*) held by the issuer. This requirement will not apply where the customer was not registered in such register or explicitly waives such registration.

To the extent that registered shares with limited transferability *(vinkulierte Namenaktien)* of a listed Swiss stock company are the securities being transferred, this registration requirement may need to be brought in line with the revised registration rules for shares of Swiss stock companies if the proposed new article 685d (2) of the Swiss Code of Obligations were to be adopted (reference is made to the message of the Swiss government to the Parliament regarding the amendment of the Swiss Code of Obligations dated 21 December 2007, BBl 2008, page 1665). If adopted, such new art. 685d(2) would allow the issuer, at its discretion, not to register the borrower as shareholder in the shareholders' register.

### 3) SLB Circular and pre-existing counterparty-specific Regulation

#### a) Introducing product-specific Regulation

The SLB Circular introduces a product-specific regulation for SLB Transactions entered into by banks and securities dealers. For certain types of counterparties, SLB Transactions are already subject to certain regulatory requirements. While the SLB Circular will be applicable to the bank or securities dealer when entering into such transactions, the counterparty-specific regulation is relevant for the counterparty concerned. This overlay of two different regulatory regimes may give rise to the question of what rules will prevail in the event that conflicting rules should exist.

#### b) SLB Transactions entered into with Pension Funds

For pension funds subject to the supervision of the Swiss Federal Office of Social Insurance ("OSI"), the OSI has expressed the view that the investment regulations of the pension fund must specify that the relevant provisions applicable to collective investment schemes apply to pension funds by analogy (see <http://www.bsv.admin.ch/aufsichtbv/02024/02075/02498/index.html?lang=de>). Such rules include article 1 to 10 of the FINMA Collective Investment Schemes Ordinance (FINMA-CISO). These requirements are generally more stringent than the requirements of the SLB Circular. However, in some respects, the SLB Circular goes further (e.g. including a right of the customer to terminate transactions without notice or introducing the disclosure requirements set out under paragraph 2 (c) above).

### c) SLB Transactions entered into with Fund Management Companies (Fondsleitungen) or SICAVs

For SLB Transactions entered into with fund management companies *(Fondsleitungen)*, the provisions of the SLB Circular will not apply. Such transactions will be subject to the requirements of article 1 to 10 FINMA-CISO. Where the SLB Transaction is entered into with a SICAV, the SICAV would have to adhere to article 1 to 10 FINMA-CISO, while the borrower would be subject to the provisions of the SLB Circular (see paragraph 1 above).

### d) SLB Transactions entered into with Insurance Companies

For SLB Transactions entered into with insurance companies regulated under the Insurance Supervision Act (ISA), the bank or securities dealer will not be subject to the SLB Circular, as such counterparties are excluded from its scope of application (see paragraph 1 above). To the extent that the securities subject to the SLB Transaction form part of the allocated assets of the insurance company within the meaning of article 17 et seq. ISA, such transaction will be subject to article 75 of the Ordinance on the Supervision of Private Insurance Companies and the requirements of FINMA Circular 2008/18.

### e) SLB Transactions entered into by a Bank with Counterparties having entered into an Asset Management Contract

SLB Transactions may be entered into by a bank as borrower with counterparties that have, in addition to the securities lending arrangement, also entered into an asset management contract with the bank. Except where such counterparties are banks, securities dealers, fund management companies *(Fondsleitungen)* or insurance companies, the SLB Circular will apply. In addition to complying with the SLB Circular, the bank will also have to meet the requirements of the Guidelines on Investment Management Mandates of 21 December 2005 published by the Swiss Bankers Association.

## 4) Implementation of the SLB Circular

From 30 June 2010 SLB, Transactions will have to comply with the requirements of the SLB Circular. For existing SLB Transactions, Swiss banks and securities dealers have a grace period until 31 December 2010 to ensure that the requirements of the SLB Circular set out in paragraphs 2 (a) to 2 (c) above are complied with.

Where SLB Transactions are entered into with retail customers that need to be collateralised according to the SLB Circular (see paragraph 2 (a) above), it may be difficult for the bank or securities dealer to justify the set-up of individual collateral accounts for each customer, where the securities that may be borrowed under the securities lending program do not reach a certain minimum threshold. In this respect, banks and

securities dealers may consider introducing a solution that allows a pooled collateralisation of such customers.

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## Novartis announced USD 5 Billion Bond Issue

**Reference: CapLaw-2010-20**

On 10 March 2010, Novartis announced a USD 5 billion bond marked transaction consisting of three tranches (USD 2 billion 1.900% Notes due April 24, 2013; USD 2 billion 2.900% Notes due April 24, 2015; USD 1 billion 4.400% Notes due April 24, 2020). These notes are registered with the U.S. Securities and Exchange Commission under an automatic shelf registration statement filed by Novartis in 2008. All three tranches are issued by Novartis AG, which is incorporated in Switzerland and is the ultimate parent company of Novartis Capital Corporation.

## UBS Investment Bank plans a new Dark Pool in Europe

**Reference: CapLaw-2010-21**

On 9 March 2010, UBS Investment Bank announced to launch a new dark pool structured as a "multilateral trading facility" (MTF) for crossing orders in European stocks. The new MTF will be open to all market players and provide immediate post-trade data. It will start business once the UK Financial Service Authority gives the green light.

## 7th Zurich Conference on Corporation Law (7. Zürcher Aktienrechtstagung)

Thursday, 1 April 2010, 09.00–15.30 h
Park Hyatt, Zurich

www.eiz.uzh.ch

## International Capital Market Association Annual General Meeting and Conference

Wednesday, 26 Mai–Friday, 28 Mai 2010
Square in Brussels

www.icma-group.org

## Developments in Financial Markets Law (Entwicklungen im Finanzmarktrecht VII)

Thursday, 27 Mai 2010, 09.15–16.20 h
Lake Side Casino Zürichhorn, Zurich

www.irp.unisg.ch