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New Amendments to Swiss Federal Act on Stock Exchanges and Securities Trading Strengthen Rules on Insider Trading, Introduce Other Important Changes

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In September 2012, the Swiss parliament approved a draft bill to revise the Swiss Federal Act on Stock Exchanges and Securities Trading (SESTA) and thus create a more stringent capital market criminal and regulatory law (New SESTA).

The New SESTA is expected to enter into force on April 1, 2013.

The revision aims at strengthening the Swiss financial market's integrity and competitiveness by adapting Swiss capital market criminal and regulatory law to international standards, thereby creating rules which efficiently sanction stock market offences and market abuse. The revision also includes amendments to the disclosure law and the takeover law.

This article discusses the key changes to SESTA.

Insider Trading

Currently, insider trading is an offence which can be committed only by the types of persons expressly mentioned in Article 161 of the Swiss Penal Code (SPC) who have access to material, non-public information due to a privileged position (*Sonderdelikt*), such as directors or managers, auditors or agents of the company (issuer), members of a government agency or public servants, or any auxiliary persons to any of the aforementioned persons. In contrast, employees without direct contact with the decision-makers of such a company, shareholders or persons who incidentally become aware of confidential information are not covered by this provision. This narrow definition was heavily criticised as failing to sufficiently protect the functioning of the financial market and the equal treatment of investors.

In order to improve this situation and to harmonise Swiss law with the law of most EU member states, the definition of insiders has been expanded.

Article 40 New SESTA foresees the following groups of insiders:

- A "primary insider", in addition to those persons who can already be insiders under current law, can be anyone who, due to his or her activities (such as the head of the M&A department or the legal department) or shareholding, has access to inside information. A primary insider is sanctioned with imprisonment of up to three years, or five years (if

qualified, as discussed below), or with a fine (Article 40 paragraph 1 New SESTA);

- A "secondary insider" (currently referred to as a tippee) is a person who receives targeted information from a primary insider (such as a journalist who is informed beforehand about confidential information) or a person who obtains information through the commission of a crime or misdemeanour. A secondary insider is sanctioned with imprisonment of up to one year or with a fine (Article 40 paragraph 3 New SESTA); and

- A person who accidentally receives inside information ("accidental insider") is sanctioned with a fine (Article 40 paragraph New SESTA).

All three kinds of insiders are liable if they realise a financial profit by taking advantage of the inside information through the purchase or sale of securities which are traded on a Swiss stock exchange or a similar institution or through the use of financial instruments derived from such securities. Primary insiders are also sanctioned if they realise a financial profit by disclosing the inside information to another person or by taking advantage of this information to recommend to another person the purchase or sale of securities publicly traded in Switzerland or the utilisation of derivative financial instruments. By including the latter, transactions with over-the-counter (OTC) products will be expressly sanctioned. Under current law, this is disputed.

To ensure compliance with the Financial Action Task Force (FATF) Recommendations and to enable the ratification of the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism of 16 May 2005, Article 40 paragraph 2 New SESTA provides for a new qualified form of insider trading under which primary insiders are punished with imprisonment of up to five years or a fine if they realise a financial profit exceeding CHF1 million (U.S.$1.1 million). Because such insider trading conduct will now qualify as a crime, it can serve as a predicate offence (*Vortat*) to money laundering.

Besides the criminal assessment of insider trading, the revision will also include a regulatory provision on insider trading (Article 33e New SESTA). Contrary to the market conduct rules prescribed by the Swiss Financial Market Supervisory Authority (FINMA) Circular 08/38, which apply to regulated market participants only, Article 33e New SESTA will apply to all market participants. The Ordinance on Stock Exchanges and Securities Trading (SESTO) will be revised (New SESTO) and contain exceptions (so-called safe harbour rules) to Article 33e New SESTA. In contrast to its criminal equivalent, Article 33e New SESTA does not require that the offender act wilfully and for financial profit and that such financial profit is realised.

Price Manipulation

The statutory offence of price manipulation will also be moved from the SPC (Article 161*bis*) to the New SESTA (Article 40a). However, the changes to this provision will contain only minor editorial revisions and precisions.

Like insider trading, and for the same reasons, price manipulation will be treated as a crime after the revision, and can therefore serve as a predicate offence to money laundering if the offender realises a financial profit of more than CHF1 million (U.S.$1.1 million) (Article 40a paragraph 2 New SESTA).

While Article 40a New SESTA will (as Article 161*bis* SPC does currently) punish only simulated transactions, the newly created regulatory provision of Article 33f New SESTA (market manipulation) will also sanction manipulative real transactions, such as ramping/camping/pegging, or squeezing/cornering, spoofing, front running and parallel running, as well as scalping. Due to this widened scope of application, the aforementioned safe harbour rules in New SESTA will have to be observed. Like Article 33e New SESTA, Article 33f New SESTA will also apply to all market participants and not require the element of financial profit.

Competence of the Federal Prosecutor

Currently, the offences of insider trading and price manipulation are prosecuted on a cantonal level and brought before cantonal courts. Pursuant to Article 44 New SESTA, the Federal Prosecutor's office is the new prosecution body. The court of first instance deciding on these crimes is the Swiss Federal Criminal Court, and appeals are judged by the Swiss Federal Supreme Court.

The reason for the new federal competence is bundling the special know-how necessary to prosecute and judge insider trading and price manipulation.

However, the Federal Department of Finance remains competent to prosecute violations of the obligation to disclose significant shareholdings (Article 41 New SESTA), which is discussed below, and of the obligation to make an offer (Article 41a New SESTA).

Changes to the Disclosure Law

Currently, the obligation to disclose shareholdings that exceed, fall below or reach certain thresholds is imposed on holders of shares in Swiss companies whose equity securities are, at least partially, listed on a Swiss stock exchange (Article 20 paragraph 1 SESTA). As a new feature, companies with their registered seats in foreign countries whose equity securities are mainly listed in Switzerland will also be covered by this provision.

There will also be additions in terms of supervisory measures. The existing instrument of suspending voting rights, currently the responsibility of the civil court judge, which has proved to be too unwieldy in practice, will newly be available to FINMA. In addition, FINMA will be given the opportunity, if there are sufficient indications of a violation of the obligation to disclose significant shareholdings, to not only suspend the voting rights of the offending shareholder, but also to issue a ban on further purchases of shares of the respective company (Article 34b New SESTA). These measures are to be revoked as soon as either the offender fulfils the

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reporting requirement or FINMA ascertains that there is no reporting requirement.

The existing Article 41 SESTA sanctions the violation of the obligation to disclose significant shareholdings according to Article 20 and Article 31 SESTA (in case of public takeover offers), with fines of up to double the purchase price. The New SESTA addresses the criticism expressed in academic writing that this punishment is draconian, and foresees a maximum fine of CHF10 million (U.S.$10.9 million).

Changes to the Takeover Law

Four key changes are foreseen for the takeover law, in addition to a few minor changes with regard to procedural matters. Like its disclosure law equivalent (Article 20 paragraph 1 SESTA, discussed above), the scope of application of Article 22 paragraph 1 SESTA will be widened to the effect that foreign companies also may be subject to Swiss takeover rules if they are mainly listed either fully or partially in Switzerland.

Under current law, in case of mandatory offers or so-called "mixed voluntary" offers (*i.e.*, if an acquiror submits a voluntary offer, the consummation of which leads to the crossing of the 33 1/3 percent threshold triggering the obligation to make a mandatory offer), the offer price may not be lower than the current market price and may not be more than 25 percent below the highest price paid by the offeror in the preceding 12 months for equity securities of the target company ("minimum price rule"). The consequence of this existing rule was that the bidder could, to a limited extent, pay the selling majority shareholders a higher price (control premium) for their shares prior to publication of his public offer to purchase than that offered to the minority shareholders in his public offer to purchase.

Under New SESTA, the opportunity to pay a control premium is removed (Article 32 paragraph 4). This additionally highlights the equal treatment of investors, a fundamental principle under SESTA, and aligns Swiss takeover rules with the EU Takeover Directive (2004/25/EC), which does not permit EU member states to allow for any control premiums under their national laws.

The same as FINMA under the disclosure law counterpart (Article 34b New SESTA, discussed above), the Swiss Takeover Board is given the authority to issue a suspension of voting rights and a ban on additional purchases in the case of sufficient indications of failure to observe the obligations to make an offer (Article 32 paragraph 7 New SESTA).

Furthermore, in order to improve the enforcement of the existing obligation to make an offer when acquiring equity securities, which, added to securities already owned, exceed the threshold of 33 1/3 percent of the voting rights of a target company (Article 32 SESTA), the wilful violation of such obligation, if established as legally binding, is punished with a fine of up to CHF10 million (U.S.$10.9 million) (Article 41a New SESTA).

Concluding Remarks

The revision of SESTA, in particular moving the offences of insider trading and price manipulation to the New SESTA and the adaptations to EU rules, will bring welcome changes to and a uniform codification of the capital market criminal and regulatory law, as well as improvements of the Swiss financial market's competitiveness and reputation on an international level. This applies particularly to the widened definition of offenders under the revised insider trading rules.

In addition, the transfer of the competence to prosecute insider trading and price manipulation to the federal level makes sense, because the cantonal authorities sometimes do not have the resources and expert knowledge to deal with these complex issues.

Furthermore, the abolition of the control premium is expected to have a positive effect on investment behaviour and, as a result, the flow of liquidity in Switzerland.

In any case, it remains to be seen whether the revised law eventually proves to be effective in legal practice.

The text of the current version of the Federal Act on Stock Exchanges and Securities Trading, in German, can be accessed at http://www.six-exchange-regulation.com/download/admission/regulation/federal_acts/sesta_de.pdf.

An unofficial English translation of the current version of the Federal Act on Stock Exchanges and Securities Trading can be accessed at http://www.six-exchange-regulation.com/download/admission/regulation/federal_acts/sesta_en.pdf.

The new and revised articles contained in the New Federal Act on Stock Exchanges and Securities Trading, in German, can be accessed at http://www.admin.ch/ch/d/ff/2012/8207.pdf.

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