

# NewsLetter

No. 53 November 2004

## Allocation Directives for Equity-Related Securities to be Publicly Offered in Switzerland

**The Swiss Bankers Association ("SBA") has recently promulgated new directives concerning the allocation of equity-related securities offered through a public offering in Switzerland (the "Allocation Directives"). The Allocation Directives aim to apply principles of fairness and transparency to the allocation process. This self-regulatory measure by the SBA and its member banks has been accepted by the Swiss Federal Banking Commission ("FBC") as a binding minimum standard. The Allocation Directives will become effective on 1 January 2005.**

### Background

Allegations of abusive practices in allocating shares of initial public offerings during the internet bubble have led to a regulatory response in Switzerland. As a result,



by Dr. Johannes Bürgi  
+41 1 265 75 59  
jbuergi@wwp.ch

the Allocation Directives define rules of conduct for the allocation process and apply to all public placements of shares, participation certificates and dividend-right certificates, as well as convertible, exchangeable and warrant bonds in Switzerland ("Allocated Securities"). The

Allocation Directives continue to

allow for differences in the treatment of individual clients or client groups based on legitimate, objective criteria.

### Public Offerings in Switzerland

The Allocation Directives only apply if a public offering of Allocated Securities occurs in Switzerland. The term "public offering" is not explicitly defined under Swiss law. Any invitation to subscribe for Allocated Securities is public unless addressed to a limited group of persons. A vast majority of authors believe a public offering has not been made if (i) the offer is made only to a limited circle of persons and/or (ii) the investors are contacted individually. Some authors are of the opinion that – as a rule of thumb – an offering qualifies as a private placement if not more than 20 persons, who have been

identified in advance, are contacted individually. Such quantitative criteria, however, serve only as a preliminary indication as to whether an offering is a public offering or a private placement. The type of investors targeted for the offer is not relevant to the determination of whether an offering of Allocated Securities is a public offering or a private placement.

The SBA seems to take the view, though, that the Allocation Directives would not apply to private equity transactions (even if offered in a "public offering" as defined above) but only to public equity transactions that are publicly offered in Switzerland, which implies that the Allocated Securities must be listed on an exchange, whether in Switzerland or abroad.

### Binding Minimum Standards for Banks

The Allocation Directives apply to all banks domiciled in Switzerland, including branch offices and subsidiaries of foreign banks that engage in public offerings in Switzerland (each a "Bank"). Circumvention of the Allocation Directives by resorting to parent companies, subsidiaries or branch offices outside Switzerland is prohibited. Even though issued by a self-regulatory organization, the Allocation Directives have been recognized by the FBC as a minimum standard for Banks. This means that auditors recognised under regulatory law are required to monitor compliance with the Allocation Directives on behalf of the FBC. Also, explicit reference to the Allocation Directives is made in the current draft of the FBC's Market Abuse Circular (see our NewsLetter No. 49 of May 2004).

### Allocation Principles and Specific Prohibitions

Generally, a Bank must define and document its allocation procedures. They must be based on legitimate, objective criteria which can be complied with by the responsible departments of the Bank and which permit compliance to be reviewed by the Bank's licensed auditors and supervisory authorities, such as the FBC. The Allocation Directives explicitly state (and the majority

of scholars seem to agree) that an investor does not have a right to an allocation.

Allocations made in exchange for an agreement to provide special favours are prohibited. These include in particular:

*Quid pro quo allocations.* A prohibition on the offer to allocate, or threat or withhold allocation of, Allocated Securities in exchange for the payment of excessive commissions or commission surcharges. Though not specifically mentioned in the Allocation Directives, trading activity that serves no economic purpose other than to generate compensation for the Bank (e.g., wash sales) would most likely be viewed as a form of excessive commissions.

*Spinning.* A prohibition on the allocation of Allocated Securities to investors (such as directors of a potential investment banking client of the Bank) in exchange for commitments or offers of business benefiting the Bank.

*Laddering.* A prohibition on the allocation of Allocated Securities to investors in exchange for a commitment to purchase more securities after the placement of the Allocated Securities in the market.

### **Allocations to Private Investors**

The Allocation Directives require Banks to ensure that allocations to private investors or private client groups are made in a fair and impartial manner and that differences in allocations which favour some private investors or private client groups to the disadvantage of others are based on legitimate, objective criteria, such as (i) order sizes, (ii) the percentage amounts of the subscriptions, (iii) drawing lots for allocations, (iv) the time when the subscription order is received, (v) the investor's long-term commitment to the issuer, (vi) the investor's portfolio structure, and (vii) the length of customer relationship. Clearly, to the extent practicable, the most transparent allocation mechanism is a pro rata allocation.

### **Allocations to Nostro Accounts**

Nostro allocations (allocations made to banks in the underwriting syndicate for market making or price stabilisation purposes) are only permitted by arrangement with the issuer and on an appropriate scale. This rule is a direct response to a publicized case in Switzerland in which a Bank allocated a substantial amount of Allocated Securities to itself and subsequently sold such securities with a substantial profit. The FBC forced the Bank to pay the profit to a charitable organization.

### **Increased Disclosure Obligations**

Offering materials must include additional information on any over-allotment option (so-called greenshoe options), including the parties to the over-allotment option, its volume and its maturity. Transparency also is required in respect of specific allocations requested by the issuer, for example to business partners or employees (friends-and-family-programmes). Once the transaction has been completed, the lead bank must disclose the placement volume, together with the size of allocations made to any categories of subscribers having special connections to the issuer and any greenshoe options exercised.

### **Outlook**

Most standards contained in the Allocation Directives appear to leave significant leeway for interpretation. To be sure, it will not be advisable to change the applicable allocation criteria for each transaction. Rather, the allocation criteria, once established, should be maintained over a certain period of time. Overall, the Allocation Directives should make Banks and issuers more vigilant about allocation practices which could be regarded improper.

### **NewsLetter**

The ww&p NewsLetter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

© Walder Wyss & Partners, Zurich, 2004



**Walder Wyss & Partners**  
**Attorneys at Law**

Münstergasse 2  
P.O. Box 2990  
CH-8022 Zurich  
Phone +41 1 265 75 11  
Fax +41 1 265 75 50  
reception@wwp.ch  
www.wwp.ch

London Representative Office  
9 Gray's Inn Square  
London WC1R 5JQ  
Phone +44 20 7405 2043  
Fax +44 20 7405 0605