

## Buyback of equity and debt securities in Switzerland

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*Markus Pfenninger and Lukas Wyss, Walder Wyss & Partners Ltd*

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A substantial number of buyback programmes have been launched in the Swiss equity and debt capital markets over the past three years, with a substantial increase of bonds and convertible bonds buybacks in 2009. Before the financial crisis, issuers launched buybacks to either:

- ❑ Take advantage of more efficient refinancing conditions in the debt capital market.
- ❑ For equity securities, repay excess funds to shareholders with a view to increasing return on equity.

However, many buyback programmes were stopped when the financial markets crumbled in 2007. Certain equity buyback programmes, initially designed to enhance shareholder value by cancelling the bought-back shares, were amended to allow the re-sale of the securities repurchased. Additionally, various listed investment companies decided to buy back some of their shares due to the lack of investment opportunities during the past two years.

As a result, there are many legal and regulatory issues that have triggered numerous decisions of general relevance. The Swiss Takeover Board (TOB), a regulatory authority established under the Swiss Act on Stock Exchange and Securities Trading (SESTA), is the principal source for administrative guidance relating to buyback programmes. It monitors issuers' and investors' compliance with the takeover law regime, and issues orders and guidelines. The Swiss Financial Market Supervisory Authority (FINMA) supervises the TOB.

This chapter provides an overview of the current practice in relation to the buyback of equity and debt securities in the Swiss capital markets, including:

- ❑ In relation to equity securities, the takeover law regime and exemptions from it, corporate law restrictions, insider trading, disclosure of substantial shareholdings and ad hoc publicity.
- ❑ In relation to debt securities, the contractual framework and other legal considerations.
- ❑ In relation to convertible bonds, the takeover law regime, corporate law restrictions and other legal considerations.

### Buyback of equity securities

Depending on the structure of the equity securities' buyback programme, various laws and regulations apply, such as:

- ❑ Corporate law.
- ❑ Stock exchange regulations.
- ❑ Public takeover law.

### The takeover law regime

Most offers by issuers to buy back equity securities from their shareholders are deemed public offers. Therefore, the offer is subject to the takeover law regime (in the same way as any other public tender offer), as contained in the SESTA (the TOB has consistently ruled that the SESTA provisions on public takeovers apply to buyback offers (under Article 2(e))).

The TOB guidance as to what constitutes a public offer or a non-public offer is not certain.

Whether an offer is public or not must be carefully assessed on a case by case basis. The TOB applies a quantitative and a qualitative test. Generally, an offer is considered to be non-public, if both:

- ❑ The offer is only addressed to a very limited number of investors.
- ❑ Investors are approached on an individual basis.

However, even if not publicly announced, an offer may still be qualified as public if the number of addressees would make it impossible or unlikely that either (*TOB Order 0067/04 relating to Intersport PSC Holding AG, dated 11 August 2000*):

- ❑ The addressees can co-ordinate their behaviour in relation to the offer.
- ❑ Individual negotiations with the issuer may occur.

An offer made to more than 60 shareholders, if no separate negotiations with the individual shareholders will occur, is very likely to constitute a public offer.

### Exemptions from the takeover law regime

If the takeover law regime applies for a public equity share buyback offer, the issuer may still be entirely exempt from its application or subject to relaxed standards.

The TOB promulgated certain safe harbour rules and exemptions for buybacks of equity shares by issuers in Release No. 1 on Equity Security Repurchases, as amended (Release). The Release grants important exemptions from the takeover law regime.

**General exemption (*section II*).** If the buyback offer relates to not more than 2% of the offeror's share capital, the buyback is fully exempt from the takeover law regime. The TOB need not be notified.

**Exemption by request (section III).** If a buyback offer is not eligible for the exemption under section II of the Release, the issuer can submit a request for exemption(s) to the TOB, together with a draft of the buyback offer. The draft buyback offer must contain the minimum information contemplated in the "form of exemption via reporting procedure", which is posted on the TOB's website ([www.takeover.ch](http://www.takeover.ch)). For details of the section III exemptions, see box, *Section III exemptions*.

**Section IV exemption.** Where a buyback offer does not satisfy the requirements under section III, the TOB can, on a detailed request by the issuer, exempt other buyback offers (provided the exemptions are in line with SESTA's objectives). The request must include all documents establishing that the requirements for exemption are fulfilled.

For information on the TOB's recent practice relating to these exemptions, see box, *The TOB's recent practice*.

## Corporate law restrictions

**Requirements for acquiring own shares.** Under Swiss corporate law, a Swiss company can acquire its own shares irrespective of whether its shares are listed on an exchange or not if all of the following apply:

- ❑ The share acquisition is not in excess of 10% of the company's share capital (for registered equity shares, the threshold is 20% in particular circumstances) (*Article 659, Code of Obligations*).
- ❑ The acquisition of the shares must be financed by retained earnings and/or freely distributable reserves.
- ❑ All shareholders must be treated equally when offering a buyback. The company must:
  - ❑ address a buyback offer to all shareholders of all categories of shares (unless there are valid reasons to do otherwise and there is no economic discrimination in relation to other shareholders);
  - ❑ offer identical economic terms (in particular price) to all shareholders;
  - ❑ structure the repurchase at arm's length.

**Exemptions.** Swiss legal scholars state that the limitations contained in Article 659 of the Code of Obligations are subject to exemptions. For example, a Swiss company can repurchase its own shares in excess of the 10% threshold, if both:

- ❑ The shareholders approve the repurchase (with a subsequent reduction of share capital).
- ❑ The procedure for reducing share capital is and will be complied with.

Previously, buybacks in excess of the 10% threshold were basically executed in two steps:

- A general shareholders meeting took a decision on the buyback programme.
- After completion of the buyback programme, the shareholders meeting took a decision on the capital reduction (*Article 732 et seq, Code of Obligations*).

However, TOB Order 408/01 relating to Partners Group Holding AG, dated 2 April 2009 (confirmed by, among others, Order 414/01 relating to shaPE Capital AG, dated 29 May 2009 and Order 420/01 relating to HBM BioVentures AG, dated 4 September 2009) contained the TOB's updated practice relating to buyback programmes that may result in a repurchase and holding of 10% or more of own shares. It required the issuers to take all of the following corporate actions to comply with Article 659 of the Code of Obligations:

- Obtain a special audit report to confirm that, taking into consideration the contemplated reduction of share capital, all of the issuer's creditors are still covered by assets of the company.
- Hold a general shareholders meeting to take a decision, based on the special audit report, on the share capital reduction. Unless the articles of incorporation provide otherwise, a single majority of the shareholder votes present at the shareholder meeting constitutes the relevant quorum.
- A creditors' call must be made three times promptly after the shareholders meeting (in the Swiss Official Gazette of Commerce), allowing creditors to request within two months their claims to be satisfied or secured.

The 10% threshold may only be exceeded once the two month waiting period has lapsed following the last creditor's call. The shareholders must take their decision on the actual share capital reduction at the next shareholders meeting, no later than the next annual general shareholders meeting (a new special audit report and a new creditors' call may be necessary).

Legal scholars dispute whether the TOB has the authority to issue orders affecting corporate law; the prevailing view is that the TOB lacks this authority. However, the TOB's current practice shows that it is difficult to present buyback programmes with a corporate law structure that has been rejected in prior transactions (*TOB Order 408/01 relating to Partners Group Holding AG, dated 2 April 2009*).

The TOB is currently revising the Release. The draft new Release, dated 24 April 2009, suggests that the TOB intends to implement its practice developed in Order 408/01 and Order 420/01 (see *above*). Legal scholars and practitioners challenged this during the hearing process for the revised Release, and it is currently unclear whether the TOB has taken these challenges into consideration.

### **Insider trading and the FINMA's market abuse rules**

Under Swiss criminal law, any shareholder, director, manager or other insider using price-sensitive

and confidential information about an issuer when buying or selling securities listed on a stock exchange, may be punished by a fine or imprisonment if the transaction results in an economic benefit for the acquirer or seller. Additionally, any person trying to manipulate the price of securities on a Swiss exchange, with the aim to achieve an economic benefit, may be punished by fine or imprisonment.

The launch of a buyback programme and completion of repurchases must comply with insider trading and market abuse rules. The blackout period rules in the Release are designed to mitigate the risk of potential non-compliance. However, issuers are advised to give ample attention to these potential pitfalls, in particular if they use in-house trading desks for the buyback or delegate the repurchase transaction to third party brokers.

In addition, Circular No. 08/38 of FINMA on market behaviour applies to FINMA-regulated brokers and dealers that are involved in a buyback programme (as financial adviser or agent). This imposes further obligations on brokers and dealers relating to the use of price sensitive information, acting in good faith, organisational requirements and so on.

### **Disclosure of substantial shareholdings**

Any person that acquires or sells shares in a company listed on a Swiss exchange and reaches, exceeds or falls below a certain threshold, must disclose to the Disclosure Office of the relevant stock exchange, and to the issuer, the:

- ▣ Transaction.
  
- ▣ Number of voting rights and shares directly (or indirectly) controlled.

The relevant thresholds are 3%, 5%, 10%, 15%, 20%, 25%, 33 1/3%, 50% and 66 2/3%. This disclosure duty also applies to the offeror in relation to its own shares held or acquired in connection with a buyback.

### **Ad hoc publicity**

Issuers must publicly disclose any price-sensitive information to the market, if it is not already publicly known (*Article 53, SIX Swiss Exchange (SIX) Listing Rules*) (see also the SIX Directive on Ad hoc Publicity). Buyback programmes relating to equity shares typically have a significant influence on a share's market price.

### **Buyback of debt securities**

Given the recent market conditions, many debt securities' issuers considered repurchasing certain of their outstanding bonds. Some issuers were able to repurchase at a discount.

SESTA and its takeover provisions do not apply to bond buybacks of Swiss-domiciled issuers whose bonds are listed on a Swiss exchange, provided the bond does not provide for either:

- An equity option.
- A conversion feature.

SESTA does not contain any specific offer rules for non-Swiss issuers whose bonds are listed on a Swiss exchange or placed with Swiss-domiciled investors.

### **Contractual framework**

A bond's terms and conditions, and the law governing the terms and conditions, should allow an issuer a repurchase. It is usually advisable to analyse whether the bond's terms and conditions provide for an early redemption clause (exercisable if a certain amount of the bond has not been tendered and remains outstanding after the end of the offer period ("clean-up call")).

### **Other legal considerations**

Bond buybacks remain subject to:

- Insider trading.
- Market manipulation.
- FINMA's market abuse rules.

Whether or not the buyback of a bond listed on the SIX is subject to ad hoc publicity rules (*Article 53, SIX Listing Rules*) should be analysed on a case by case basis.

Generally, the launch of a bond buyback programme is typically deemed to have less of an affect on the price building of its securities.

### **Buyback of convertible bonds**

Some convertible bonds contain early redemption features that the issuer can exercise. However, depending on market conditions, it may be more attractive for the issuer to repurchase the bonds on the market. In relation to mandatory convertible bonds, an early redemption may not be an appropriate option for the issuer, as it could result in a dilution that may not be desirable if the issuer has access to other financing sources.

### **The takeover law regime**

In relation to Swiss issuers' recent convertible bond buybacks, the TOB held that the takeover law regime and the Release apply to any bond listed on a Swiss stock exchange (if the bond is convertible into equity securities of the issuer). These rules also apply to issuers that have issued and listed hybrid securities on a Swiss exchange, in relation to regulatory or rating agency capital

purposes. Therefore, a buyback offer relating to convertible bonds could also trigger a buyback obligation relating to the issuer's other equity securities on a Swiss exchange (*section III 1.3, Release*).

However, the nature of the convertible bond can vary substantially. In certain circumstances (for example, where the convertible bond is far out of the money (OTM) (that is, its strike price is higher than the market price of the underlying asset), the convertible bond's debt feature dominates. Therefore, when applying case law (in particular relating to protection of investors), the variable nature of convertible bonds is taken into consideration and case law is not applied in a uniform manner (particularly when considering whether to grant an exemption from the takeover law regime under the Release).

The TOB has held that sections III 1.2 and 1.3 of the Release need not be complied with in all situations to exempt a convertible bond buyback from the takeover law regime (*Order 419/01 relating to Petroplus Finance Ltd, dated 18 August 2009 and Order 419/02 relating to Petroplus Finance Ltd, dated 10 September 2009*). Therefore, the buyback offer can be limited to the convertible bond and need not comprise all equity securities listed on a Swiss exchange. In addition, the TOB ruled that the buyback offer may lead to a subsequent de-listing of the bond.

The TOB further granted an exception to the rule in the Release that an offer must not be conditional (*section III 2.2, Release*). The following conditions are acceptable, depending on the facts and circumstances of the offer:

- Conditions relating to a minimum percentage of convertible bonds to be tendered.
- Conditions relating to the completion of certain refinancing transactions (with which the issuer aims to replace the bond subject to the buyback offer).

The TOB included an economic analysis in its reasoning, considering that the call option has no economic value and therefore it could not be expected that any bondholder would exercise its call option attached to the bond. The bond would be predominantly characterised as a straight debt instrument supporting a more relaxed interpretation of the Release (and SESTA), designed to protect equity and equity-linked investors. However, the TOB did not grant an exemption requested by the issuer relating to a staggered downward offer pricing (common in the Eurobond market) that provided for a reduced repurchase price for bondholders during the last ten days of the offer period only. The TOB concluded that this pricing would violate the equal treatment requirement under the Release and SESTA.

### **Corporate law restrictions**

The 10% restriction on equity under corporate law does not apply to convertible bonds (although treasury shares held by the issuer on exercise of the conversion right are subject to this restriction).

### **Other legal considerations**

The controlling of option or conversion rights are subject to the same disclosure obligations as for

equity securities (see above, *Buyback of equity securities: Disclosure of substantial shareholdings*).

As other bond buybacks and buybacks of convertible bonds remain subject to the insider trading rules, the following rules apply:

- ▣ Market manipulation and the FINMA's market abuse rules (see above, *Buyback of equity securities: Insider trading and the FINMA's market abuse rules*).
- ▣ The ad hoc publicity rules of the SIX (Article 53, *SIX Listing Rules*) (see above, *Buyback of equity securities: Ad hoc publicity*).

### The TOB's recent practice

The TOB has recently granted exemptions to the 10% limitation in section III 1.1 of the Release (on request by the issuer under section IV), if the offer of more than 10% of the issuer's capital or voting rights would not result in both a (*TOB Order 420/01 relating to HBM BioVentures AG, dated 4 September 2009, and Order 0355/01 relating to SwissRe, dated 25 February 2008*).

- ▣ Substantial change of shareholding.
- ▣ Substantial reduction of the free float.

The 10% limitation originates from Swiss corporate law and it is arguable whether the TOB has authority to monitor offerors' compliance with corporate law.

Other recent exemptions involve the issuer claiming that the purpose of the buyback has changed and that it now intends to resell the shares (rather than reduce the share capital by way of cancellation of the repurchased shares). The TOB held that any change to a pending buyback programme requires the requesting issuer to provide a "reasonable rationale" justifying a change in the pending programme's market expectation. However, the TOB confirmed that a resale of bought-back shares for financing purposes, particularly in distressed market conditions, constitutes a reasonable rationale (*TOB Order 355/02 relating to SwissRe, dated 17 February 2009 and TOB Order of 29 January 2009 relating to Forbo Holding AG*). The TOB usually rejects requests for buybacks that contain alternative purposes clauses (for example, cancellation of the shares or resale of the shares subject to the discretion of the offeror's board of directors (*TOB Order 408/01 relating to Partners Group Holding AG, dated 2 April 2009*)).

### Section III exemptions

The TOB can grant an exemption if the following conditions are satisfied:

- ▣ **Section III 1.** Exemption requirements for fixed-price and market-price repurchases:



- 1.1: The amount of the buyback offer must not exceed 10% of the offerors's capital or voting rights;
  - 1.2: The execution of the repurchase must not lead to the de-listing of the shares concerned;
  - 1.3: The buyback offer must comprise all categories of listed shares issued by the offeror;
  - 1.4: On the first trading day after the end of the offer period, the offeror must report the total number of shares repurchased in each category.
- **Section III 2.** Additional exemption requirements for fixed-price buyback offers (including for put options written by the issuer and granted to shareholders):
- 2.1: The offer must not be publicly announced (blackout periods) if:
    - price-sensitive information is available to the offeror but not yet disclosed under the relevant listing rules,
    - during ten trading days before publication of the offeror's financial results; and
    - if the offeror's latest consolidated financial statements date back more than nine months.
  - 2.2: The offer must not be conditional;
  - 2.3: The offeror must ensure that the differences between various offer prices for various categories of shares are proportionate;
  - 2.4: If the number of shares surrendered exceeds the number of shares for which a buyback offer has been made, the number of shares surrendered by shareholders must be reduced in proportion to the number of shares for which the offer has been made;
  - 2.5: If, during the offer period, the offeror acquires shares at a higher price, it must offer this price to all tendering shareholders ("best price" rule).
  - 2.6: Publication of the buyback offer must be made at least ten trading days before the end of the offer period. If no offer price is contained in the publication, the offeror must publish the offer price via electronic media at least three trading days before the offer's end. The offer can only be accepted after the offer price's publication;
  - 2.7: On the first trading day after the end of the offer period, the offeror must confirm to the TOB in writing that the requirements of section 2.1 to 2.5 have been met.

- **Section III 3.** Additional exemption requirements for repurchases at market price:
  - 3.1: The offeror must suspend repurchases during the same blackout periods as described in 2.1 above;
  - 3.2: If the buyback offer relates to several categories of shares, the offeror must place bids for each share category at the same time;
  - 3.3: During the buyback period, the offeror must not, on the regular trading line, repurchase more than 25% of the shares' average daily trading volume (based on the daily volumes of the last 30 trading days on that trading line). Block trades are exempt if the price paid for the block does not exceed the last price paid or the last price quoted by an independent third party;
  - 3.4: The offeror must not place repurchase orders during the opening and closing auctions, nor during the auction performed after a "stop trading";
  - 3.5: If the repurchases are executed through a separate trading line, the price offered on the separate trading line must not exceed the price offered on the regular trading line by more than 5%;
  - 3.6: If the repurchases are executed through the regular trading line, the offeror must disclose (every ten trading days) the numbers of shares traded and the net number of shares purchased since the beginning of the buyback programme;
  - 3.7: Sections 3.1, 3.3, 3.4 and 3.6 do not apply to the daily trading activity of banks and securities dealers in their own shares.
  - 3.8: One trading day after the end of the offer period, the broker mandated to repurchase the shares must confirm compliance with sections 3.2 to 3.6.

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## Resource information

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