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International Securities & Capital Markets Newsletter

Recent Developments in International Securities Law

Dear Committee Members,

This is the latest issue of the International Securities & Capital Markets Newsletter, published by the International Securities & Capital Markets Committee of the American Bar Association's Section of International Law. We hope you find it interesting and useful. We generally publish this newsletter on a quarterly basis and welcome submissions regarding jurisdictions not already covered. This newsletter covers developments in the first quarter of 2013 .

A special note of thanks to our contributors, who have each prepared interesting and informative pieces. If you would like to contribute, and we very much encourage you to do so, or if you have a question or suggestion, please contact me using my details at the end of the newsletter.

Regards,

Thomas M. Britt III

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Switzerland

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Revision of Swiss Stock Exchange Law and Corporate Governance Rules

1. Introduction

In September 2012, the Swiss Parliament passed the draft bill for a revised Swiss Federal Act on Stock Exchanges and Securities Trading (SESTA). The new SESTA (nSESTA) establishes more stringent capital market rules with newly embedded criminal law provisions and regulatory standards sanctioning insider crime as well as price manipulation. The revised SESTA, which is expected to enter into force on May 1, 2013, aims at strengthening the Swiss financial market's integrity and competitiveness by adapting to international standards. The revision also includes amendments to the disclosure law and the takeover law.

On March 3, 2013, the Swiss voting public approved the fiercely debated "rip-off initiative" (*Initiative "gegen die Abzockerei*"), initiated by lawmaker Thomas Minder in 2008 (Minder Initiative). The new law is going to change the legal framework on executive compensation and other corporate governance matters for Swiss public companies. The implementation of the Minder Initiative will be the task of the Federal Council and the Swiss Parliament. Many aspects concerning said implementation will remain unclear for the months and years to come.

This article discusses the key changes to SESTA (section 2) as well as the new corporate governance rules for Swiss public companies dictated by the Minder Initiative (section 3).

2. Revision of Stock Exchange Law

2.1. Insider Trading

As of today, insider trading is an offence that can only be committed by the types of persons expressly mentioned in article 161 of the Swiss Penal Code (SPC). It is required that these persons have access to material, non-public (confidential) information due to their particular, privileged position (*Sonderdelikt*), such as directors or managers, auditors or agents of the company (issuer), members of a government agency or public servants, or as auxiliary person to any of the aforementioned. Employees without direct contact to a person having such privileged position and shareholders or persons who incidentally become aware of confidential information are not covered by this provision. This narrow definition of possible offenders has been heavily criticized as failing to sufficiently protect the functionality of the financial market and the equal treatment of investors. In order to close this loophole and to harmonize Swiss law with the law of most EU member states, the definition of insiders will now been extended. Article 40 nSESTA foresees the following groups of insiders:

- a *primary insider* may, apart from the persons who can already be insiders under current law, be anyone who due to his/her activity (such as the head of the M&A or legal department) or shareholding has access to inside information. A primary insider is sanctioned with imprisonment of up to three, respectively five (if qualified, cf. below) years, or with a fine (article 40 paragraph 1 nSESTA);

- a *secondary insider* (until now referred to as tippee) is a person who receives targeted information from a primary insider (such as a journalist who is informed about confidential information in advance) or a person who obtains information through the commission of a crime or misdemeanor. A secondary insider is sanctioned with imprisonment of up to one year or with a fine (article 40 paragraph 3 nSESTA); and

- an *accidental insider is* a person who accidentally receives inside information. An accidental insider is sanctioned with a fine (article 40 paragraph 4 nSESTA).

All three kinds of insiders will be liable if they realize a financial profit by taking advantage of the inside information by purchasing or selling 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 will be moreover sanctioned if they realize a financial profit by disclosing the inside information to another person or by taking advantage of this information by recommending the purchase or sale of securities publicly traded in Switzerland or the utilization of derivative financial instruments to another person. By including the latter, transactions with OTC products will be expressly sanctioned. Under the current law, this is disputed.

To ensure compliance with the Recommendations of the Financial Action Task Force (FATF) and to enable the ratification of the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of Proceeds from Crime and on the Financing of Terrorism of May 16, 2005, article 40 paragraph 2 nSESTA states a new qualified form of insider trading according to which primary insiders will be punished with imprisonment of up to five years or a fine if they realize a financial profit exceeding CHF 1 million. As this newly introduced first degree incriminated conduct on insider trading qualifies as crime, it can serve as a predicate offence (*Vortat*) to money laundering.

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

2.2. Price Manipulation

The statutory offence of price manipulation will be moved from the SPC (article 161bis) into the nSESTA (article 40a). The changes made to this provision will, however, only contain 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 realizes a financial profit of more than CHF 1 million (article 40a paragraph 2 nSESTA).

While article 40a nSESTA will only punish simulated transactions (in line with the provision of article 161bis SPC, which will be abrogated), the newly created regulatory provision of article 33f nSESTA (market manipulation) will also sanction manipulative real transactions such as ramping/camping/pegging, or squeezing/cornering, spoofing as well as scalping. Due to this widened scope of application, the aforementioned safe harbor rules in nSESTO will have to be observed. Like article 33e nSESTA, article 33f nSESTA will apply to all market participants and not require the element of financial profit.

2.3. Competence of the Federal Prosecutor

To date, the offences of insider trading and price manipulation have been prosecuted on a cantonal level and brought before cantonal courts. Pursuant to article 44 nSESTA, the Federal Prosecutor's office will be the new prosecution body. The court of first instance dealing with these cases will be the Swiss Federal Criminal Court, and appeals will be 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. The Federal Department of Finance (EFD), however, will remain competent to prosecute the violation of the hereinafter addressed obligation to disclose significant shareholdings (article 41 nSESTA), and of the obligation to make a public tender offer (article 41a nSESTA), respectively.

2.4. Changes to the Disclosure Law

Under the current disclosure rules, the obligation to disclose shareholdings that exceed, fall below or reach certain thresholds is limited to holders of shares in *Swiss* companies whose equity securities are, at least partially, listed on a Swiss stock exchange (article 20 paragraph 1 SESTA). The new disclosure rules will expand the scope of application by including shareholdings in companies with registered seat *outside of Switzerland*, provided that the equity securities are "mainly listed" (*hauptkotiert*) in Switzerland.

Further changes include the expansion of supervisory measures in case of breaches of disclosure of the relevant shareholding. To date, possible sanctions include fines as well as the suspension of voting rights by civil court order, which, however, have proved not to be practicable. Under the revised rules, if there are sufficient indicators of a violation, it will be the power of FINMA to intervene and sanction infringing shareholders by suspending their voting rights and – as a new feature – issuing a ban on further purchases of shares of the respective company (article 34b nSESTA). These measures are to be revoked as soon as either the offender fulfills the disclosure requirement or if FINMA ascertains that there is no disclosure requirement. The revised SESTA will set a cap on fines (up to CHF 10 million); under the current rules, shareholders in breach of disclosure law are facing fines, which are based on the purchase price or the sale proceeds relating to the relevant transaction.

2.5. Changes to the Takeover Law

Four key changes have been made to the Swiss takeover law, in addition to minor adjustments with regard to procedural rules. First and foremost, Swiss takeover law will no longer be

applicable to *Swiss* public companies only but also to all *foreign* public companies (provided that the shares are "mainly listed" in Switzerland (article 22 paragraph 1 nSESTA)). Under certain circumstances, the application of Swiss takeover law can be waived.

Secondly, the possibility to pay a control premium in a pre-tender offer transaction will be abolished. Under current takeover law, the mandatory tender offer regime (applicable, absent an opting out in the target company's articles of incorporation (Articles), if the offeror's shareholding exceeded 33 1/3% of the total voting rights) allow the offeror to pay a control premium over the tender offer price: While the minimum offer price in any case has to match the market price (60 day WVAP), the rules allow to set the offer price up to 25% below the highest price paid by the offeror in the preceding 12 months for equity securities of the target company (so-called "Minimum Price Rule"). The new rules will no longer permit this unequal treatment, i.e. the minimum price will have to be equal to the higher of the market price (60 day WVAP) and the highest price paid by the offeror in any pre-tender offer transaction made during the 12 months prior to the public tender offer (article 32 paragraph 4 nSESTA). The changes align the 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 law.

Thirdly, like FINMA's new power under the disclosure law counterpart (article 34b nSESTA, cf. section 2.4 above), the Swiss Takeover Board will be given the authority to suspend voting rights and to ban additional purchases in the case of sufficient indications of any failure to observe the obligations to make an offer (article 32 paragraph 7 nSESTA).

Last, in order to enhance enforcement of the obligation to make a mandatory offer when holding shares in excess of the 33 1/3% threshold (article 32 SESTA), the willful violation of such obligation will be punishable with a fine of up to CHF 10 million (article 41a nSESTA).

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3. New Corporate Governance Rules for Swiss Public Companies

3.1. Minder Initiative approved by Swiss voters in March 2013

On March 3, 2013, the Swiss voting public approved the Minder Initiative, which is going to introduce significant changes to corporate governance rules in Swiss companies whose equity securities are listed on a Swiss (or foreign) stock exchange. The 24-item measure covered by the Minder Initiative, which has yet to be implemented, provides, among other rules, for the following key aspects:

Say-On-Pay: the general meeting of shareholders (GM) shall vote on the aggregate compensation amount of the Board, the executive management and the advisory board (*Beirat*). This vote is mandatory and binding. Severance or "other" compensation payments, advance payments, transaction incentive payments to members of the Board or the executive management will be prohibited. Additional consulting or employment agreements with such members are no longer permitted either.

New Election Procedures: the GM shall elect the chairman of the Board, and, individually, each Board member as well as each member of the compensation committee. The GM shall further elect the independent proxy (*unabhängiger Stimmrechtsvertreter*). Corporate proxy (*Organvertretung*) and depositary proxy (*Depotstimmrechtsvertretung*) shall no longer be

permitted. Electronic voting by shareholders shall be allowed. Pension funds must cast their votes in the interest of the insured and disclose how they voted.

Additional Specific Rules in the Articles: the Articles shall include specific compensation rules, in each case covering both the members of the Board and the executive management, concerning the following items: (i) the amount of loans, credit facilities and post-retirement benefits; (ii) bonus schemes and compensation plans; and (iii) number of mandates outside the group. The duration of employment agreements with the executive management needs to be addressed in the Articles as well.

Criminal Sanctions: any violation of the new rules shall be sanctioned with imprisonment of up to three years and a fine of up to six times the annual compensation.

3.2. Entry Into Force

The Federal Council and the Swiss Parliament must adopt the legislation implementing the Minder Initiative. The Minder Initiative requires the Federal Council to implement the new rules within one year (i.e. until March 3, 2014) by means of an ordinance. This ordinance will govern the subject matter at least temporarily until the Swiss Parliament will adopt the respective implementing legislation, which, however, remains subject to a (in this case generally considered rather unlikely) facultative referendum. It is assumed that a first draft of the Federal Council's implementing ordinance will be available to the public in late summer 2013. One should expect entry into force to occur on a date that will unlikely affect the 2014 GM season.

4. Concluding Remarks – Outlook

The revision of SESTA, in particular moving the offences of insider trading and price manipulation into the nSESTA and the adaptations to the EU rules, will bring welcome changes to and a uniform codification of the important capital market principles 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 rules. Furthermore, the transfer of the competence to prosecute insider trading and price manipulation to the federal level is prudent as the cantonal authorities often do not have the resources and expert knowledge to deal with these complex issues.

The approval of the Minder Initiative came amid efforts in the EU to curb bank executives' bonuses and the Dodd-Frank Act in the US, which has given shareholders a nonbinding say-on-pay vote in 2011. Against that backdrop, stricter corporate governance rules, which strengthen shareholder right, are becoming standard. Contrary to the revised SESTA, the Minder Initiative has yet to be implemented by the Federal Council and the Swiss Parliament. Companies affected by the Minder Initiative should resist rushing into any (premature) modifications, but stay alert and carefully monitor the upcoming legislative implementation of the Minder Initiative by the respective governing bodies.