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Swiss Capital Contribution Principle

Reference: CapLaw-2010-63

As per 1 January 2011 a new regulation in the Swiss tax law concerning the tax treatment of the repayment of capital contributions enters into force. According to the new rules the repayment of capital contributions is exempt from Swiss income tax (if the shares are owned as private means) and Swiss withholding tax.

By Xenia Athanassoglou / Barbara Brauchli Rohrer

1) Overview on the New Regulation

The exemption on taxes for repayment of capital contributions applies to all capital contributions made after 31 December 1996. According to the law and the circular letter published by the Swiss Federal Tax Administration (FTA), very strict formalistic rules and deadlines have to be followed.

All capital contributions made after 31 December 1996 have to be booked into a separate account in the statutory balance sheet and all changes on this account will have to be notified to the tax authorities using a specific new form. Such separate account is the first time requested for the business year ending in 2011. Additionally, the companies have to declare to the FTA the history of the capital contributions since 31 December 1996 and provide them with evidence that the reflected contributions are "true" capital contributions. Such evidence can be provided by filing financial statements, statements of account, stamp duty declarations etc.

The mentioned circular letter is dealing with some general requirements as well as with some specialties requested by the FTA. In the following some main topics are reflected.

2) Qualified Capital Contribution–Contributions from Direct Shareholders

The FTA is very strict in determining the concept of a capital contribution. According to the FTA only contributions from direct shareholders may qualify under the capital contribution principle for the tax exemption. This means that contributions for example from a "grandmother" company or from a "sister" company would not qualify as capital contribution in the sense of the capital contribution principle.

3) Hidden Capital Contributions

Based on the official interpretation of the FTA, only contributions that have been reflected in the financials of the receiving company can qualify under the capital contribution principle. Since hidden capital contributions are not accounted for, such contributions do not count for the reserves from capital contribution and therefore cannot be repaid tax free. Only during the current business year (as long as the books are not yet

closed) a hidden contribution can be openly declared and rebooked—without realizing a gain subject to tax. In such case, the contribution will be seen as a qualifying capital contribution and can be repaid tax free if the other conditions are met.

4) Set-off of Losses with Capital Contribution Reserves

Based on the interpretation of the FTA a set-off of losses against reserves from capital contributions is final and can not be revoked. Should the company have accounted losses against qualifying capital contributions in the balance sheet of the company, such set-off is final and reduces the reserves from capital contribution independently on whether in later years the capital contribution reduced by set-off with prior losses is replenished by future profits.

5) Recapitalization

The newly established practice of the FTA mandates a complete set-off (from a bookkeeping as well as tax point of view) of the existing losses with the reserves from capital contribution while granting a release of the Swiss issuance stamp tax in case of recapitalization of the company. This leads to a conflict between the interest of the company to avoid any issuance stamp tax and the interest of the shareholder for a tax-free repayment of the contributions effectively made during the recapitalization. Set-offs against reserves from capital contributions are final and reduce the benefit of a tax-free repayment (see above).

In case of recapitalizations it has to be analyzed accurately what economically makes sense—paying the issuance stamp tax versus ensuring the reserves out of capital contributions. It is recommended to carefully plan the process of contribution during recapitalization.

6) Reorganizations

Certain cases of a tax neutral restructuring result in a five year blocking period. During that blocking period some transactions are prohibited, e.g. the transfer of assets or a sale of the respective participation to a third party. In case of an infringement of this blocking period, the underlying restructuring will be treated as taxable event retroactively and will be taxed at the level of the involved parties. In general such breach of the blocking period leads to the realization of the hidden reserves on the transferred asset(s). Even though the hidden reserves are realized in such event, the step-up in basis in the books of the assuming party does not qualify as capital contribution in the sense of this principle. This could lead to the situation that the retroactively realized hidden reserves will be taxed a second time in the context of the distribution, respectively the repayment of funds to the shareholders.

7) Recommendation

To benefit from the new regulations as well as to avoid any disadvantages, the following measures should be taken:

- Reassessment, whether it would be beneficial to disclose hidden capital contributions during the current year, prior to the approval of the general assembly of the statutory financial statements
- Avoidance of set-off of qualifying capital reserves with losses
- Assessment during recapitalization which option is more favorable from a tax point of view: release of Swiss issuance stamp tax versus the set-off of losses against reserves out of capital contribution
- Identification of all capital contributions after 31 December 1996
- Timely and solid declaration of the reserves of capital contribution, i.e. a systematic schedule of all identified capital contribution after 31 December 1996
- All capital contributions after 31 December 1996 need to be booked in a separate account in the statutory balance sheet
- Systematic planning of future distributions to shareholders (dividends versus repayment of nominal value versus repayment of capital contributions) as well as of share-buy-back-programs
- For future acquisitions of companies the existence and the review of the FTA-declaration as well as the proper booking in the statutory balance sheet will represent an important part in the due diligence process
- Future contributions have to be planned properly, as in certain cases an open-booked capital contribution will be more favorable than a hidden capital contribution

With the new capital contribution principle in force as per 1 January 2011 a long-lasting nuisance will be abolished by no longer qualifying the repayment of contributions, originally made by direct shareholders, as taxable event.

Even though the capital contribution principle seems to be a quite simple concept, the implementation leads to several uncertainties and demands a good and proper planning and implementation to ensure the ability to benefit from the new regulations.

Last but not least, the circular letter published by the FTA forms some sort of safe-harbour-rule but is still only a guideline from the FTA. Differing positions by the tax payer are possible, defensible and may become acceptable after being ruled by court.

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Break Fees in Public Tender Offers

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In an uncertain market environment, bidders in public tender offers are increasingly tempted to shift risks to the target company. A break fee arrangement is one of the tools to achieve this. The permissibility of break fees is not specifically addressed by any Swiss statutory provision and hence the question whether and to what extent break fees may be validly agreed is often debated. The following article sheds light on this debate and analyzes the permissibility of break fees from a Swiss corporate law and Swiss takeover law perspective.

By Thomas Reutter / Flavio Lardelli

1) Purpose and Nature of Break Fees

Break fees can be defined as a contractual obligation to pay a specific sum of money if certain specified events occur (the "triggers") which have the effect that the agreed transaction cannot be consummated. Such a trigger can be the fact that the board of directors of the target company does not recommend the bidder's public tender offer or the bidder's tender offer does not become unconditional because a competing offer is successful (see *e.g.* offer prospectus of Crucell N.V. for the shares of Berna Biotech AG dated 15 December 2005, 16). Whereas reciprocal break fees are usually agreed in private M&A transactions, break fees in public tender offers are usually designed as unilateral break fees in favor of the bidder.

There are two main reasons for a bidder to request break fees in takeovers: Firstly, break fees can be viewed as *cost protection* in the event of a deal failure. They are intended to reimburse a bidder for costs incurred in connection with the preparation and planning of the transaction (*e.g.* costs for due diligence). The bidder intends to be indemnified in an easily enforceable way based on a contractually agreed flat-rate calculation. Secondly, break fees are intended as a measure of *deal protection* in particular to prevent competing bids. It is in the bidder's interest to negotiate a break fee at the higher end of the permitted range to reduce the risk that the bidder will not be successful. In particular, the bidder intends to make a competing offer as difficult as possible.

2) Legal Qualification

From a legal point of view, a break fee is a payment obligation subject to a condition precedent *(Suspensivbedingung).* In Swiss law, break fees can be qualified—depending on their content and purpose—either as conditional liquidated damages lump sum *(Schadenspauschalisierung)* or as conditional contractual penalties (regularly as a promise without an obligation to perform; *unechte Konventionalstrafe*). The exact qualification is not always easy and subject to interpretation, but is relevant as to the legal consequences: A contractual penalty does not require actual damages occurred and is independent from the amount of damage and can only be reduced if the penalty is excessively high (article 163 (3) Code of Obligations (CO)). Liquidated damages can be reduced if the obliged party can prove that the damage is actually smaller than the agreed lump sum amount even though some authors advocate a "fairness test" in analogy to article 163 (1) CO as well.

To avoid any undesired consequences the nature of the break fee clause should be clearly specified (see e.g. offer prospectus of AFB Investment S.A. for the shares of Forbo Holding AG dated 8 March 2005, 10 in which the break fee was called "lump-sum payment of CHF 800,000 as reimbursement of AFB Investment's expenses").

3) Corporate Law Limitations

Can the board of directors of the target company agree break fees from a corporate law point of view? Based on its duty of supervision of the company the board of directors has the power to lead the takeover proceeding as well as to sign agreements with bidders. Therefore, it is also the competent body to negotiate break fees. However, the board's action may interfere with powers of the general meeting if the break fee amount is so high that the shareholder's freedom of decision is unduly influenced. It is generally held that the amount of the break fee should be reasonable in light of the bidders costs. If the break fee appears not to be reasonably related to the damage that is likely to be sustained by the bidder, the break fee is likely to be void.

Another question is whether break fees can be in conflict with the duty of the board of directors to act in best interests of the company (article 717 (1) CO). As a general rule, the board of a target company must take all reasonable steps to obtain the best offer for the shareholders. Break fee agreements are only allowed if the planned transaction is, as a whole, in the interest of the target company. In particular, the board has to take into consideration the long term economic interests of the company and the price offered by the bidder. Furthermore, the break fee agreement itself must generate a corporate benefit. This is the case if the bidder would not make an offer without break fees or if, based on the agreed break fee, the offer price would be higher. By contrast, no corporate benefit will usually derive from a break fee that is only agreed subsequent to the publication of a public tender offer.

In case the bidder itself is a shareholder the agreed break fee can also violate the equal treatment principle of shareholders (article 717 (2) CO) or may even constitute a constructive dividend or hidden profit distribution to the extent it is not reasonably related to a bidder's costs (article 678 CO). However, in our view, the equal treatment principle does not oblige the board of directors to concede to a competing shareholder bidder the same break fee amount.

4) Disclosure in the Offering Prospectus

According to article 30 (1) Stock Exchange Act (SESTA) shareholders of the target company must be free to choose which tender offer they accept. If the target company grants a break fee to the first bidder, the break fee will effectively constitute a liability to the second bidder that succeeds in acquiring the target and may therefore deter competing bids. The board of directors can thus use a break fee as a tool to force shareholders into approving a bid that is favored by the board. Therefore, the Swiss Takeover Board (TOB) analyses whether the agreed break fee would discourage unsolicited competing bids (see TOB decision in the matter of Day Software Holding AG dated 20 August 2010, 31; TOB recommendation Saia-Burgess Electronics Holding AG dated 8 September 2005, 7.2.; TOB recommendation in the matter of Forbo Holding AG dated 7 March 2005, 8.2.). According to the TOB, the permissibility depends on the amount of the break fee: If the amount is so high to deter unsolicited competing bids, the respective break fee will not be permissible under Swiss takeover law.

Furthermore, the target company is required to treat all bidders equally (article 49 Takeover Ordinance (TOO)). An unequal treatment of any bidder is only permissible with the prior consent of the TOB and if the target company demonstrates that it has an overriding interest. This leads to the controversial question whether the target company is obliged to agree to the same break fee with the second bidder as with the first bidder. In our view, there is no such obligation under Swiss takeover law. Firstly, it would be an inadmissible restriction of freedom of contract if the target company would be forced to agree to a break fee. Secondly, the costs of the second bidder are usually lower than for the first bidder. However, the TOB left this question explicitly open in TOB recommendation Saia-Burgess Electronics Holding AG dated 8 September 2005, 7.2. and did not have the opportunity to decide it since then.

If, however, no break fee was agreed with the first (unsolicited) bidder, the board of directors may not agree a break fee with a second bidder acting as a "white knight". Doing so would be considered as an illegal defensive measure in the sense of article 29 (2) SESTA as well as an unequal treatment of bidders (article 49 TOO).

5) Break Fee Amount and Disclosure

It is controversial among legal commentators whether or not there is a rule of thumb or given "permissibility threshold" for valid break fees in proportion to the whole transaction value (e.g. 1% of the whole transaction value). The TOB is not guided by any such given threshold value (see TOB decision in the matter of Day Software Holding AG dated 20 August 2010, 32) and we believe, rightly so. Although a fix threshold would clarify the situation for the parties, it would not take into account the diversity of takeover scenarios. For example, the costs for the second bid are generally lower than for the first bid. Therefore, the threshold cannot be fix in relation to the whole transaction value. The same applies if the payment of the break fee would jeopardize the going concern of the target company in case of low liquidity.

Given the potential for responsibility claims (article 754 CO) against the board of directors of the target company, it is well advised to check the permissibility of the break fee in advance. By now, however, the break fees reviewed by the TOB have not raised any objection from the TOB or prompted any court filings.

Article 23 (1) (b) TOO requires the parties to disclose break fee agreements. The following table gives an overview of the agreed break fees from 2003 to 2010:

Year	Target	Transaction Value	Break Fee Amount	Percentage of transaction sum
2003	Centerpulse AG	CHF 3'000 Mio	CHF 20.0 Mio	0.66
2003	InCentive Capital AG	CHF 741 Mio	CHF 4.0 Mio	0.53
2005	Saia-Burgess Electronics Holding AG	CHF 695 Mio	CHF 2.0 Mio	0.31
2005	Berna Biotech AG	CHF 590 Mio	CHF 3.5 Mio	0.59
2005	Forbo Holding AG	CHF 650 Mio	CHF 800'000	0.12
2006	Amazys Holding AG	CHF 367 Mio	CHF 1.9 Mio	0.52
2009	BB Medtech AG	CHF 500 Mio	CHF 1.0 Mio	0.20
2010	Day Software Holding AG	CHF 243 Mio	CHF 3.0 Mio	1.23

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Scale and Scope of the Regulation of Share Buybacks

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Although share buybacks are regulated in Switzerland within the framework of corporate takeovers, the actual regulations focus on preventing market abuse. This tension between the legal basis and the purpose of the regulation have not only led to problems in the application of the rules but also in terms of defining their scope and scale, as illustrated by the three cases discussed in this article, regarding a program exceeding 10%, a tender offer for convertible notes and the restructuring of an employee stock option plan.

By Rashid Bahar

1) Introduction

Under Swiss law, share buybacks fall within the scope of the statutory definition of tender offers. However, early on, the regulators recognized that the rules governing corporate takeovers drafted to address going private transactions and hostile bids could hardly apply to these capital markets transactions. The Takeover Board (TOB), consequently, accepted to exempt these transactions from the ordinary regime applicable to takeovers provided they either satisfy certain requirements spelled out in Takeover Board Circular n°1: Buyback Programs or solicit a specific exemption based on the facts and circumstances of the case. From a theoretical perspective, this makes for a fascinating regime: Instead of formally reviewing each buyback program, the Takeover Board achieves the same result by way of a general or a specific exemption. Moreover, to a very large extent, while the Takeover Board disregards takeover regulation, it uses this pretext to enact de facto a regulatory market abuse regime, which is otherwise unknown to Swiss issuers who do not double up as banks or securities dealers.

However, the scale and scope of the regulation of share buybacks and the flexibility the Takeover Board is willing to concede on a case by case basis remains in flux as three recent decisions point out. This article, thus, seeks to sketch the outer frontiers of takeover regulation by commenting three cases regarding (a) quantitative limitations to buy-backs, (b) the partial application of the share buyback regime to the restructuring of convertible bonds, and (c) the inapplicability of this regime to the restructuring of stock option plans.

2) Quantitative limitations to buy-backs

In the first case, Actelion Ltd intended to launch a buyback program for an amount of CHF 800 million covering up to 15% of its share capital. The program was supposed to last three years and the company declared that it intended to cancel the treasury shares acquired under the program. In view of the scale of the buy-back, the company could not benefit from one of the general exemptions recognized by the Takeover

Board Circular n° 1: Buyback Programs and thus requested an ad hoc exemption. Considering the merits of the request, the Takeover Board found that a specific exemption could be granted if the buyback did not affect the control of the issuer and did not excessively reduce its free float. Examining how the buyback at hand would impact the latter condition, the Takeover Board relied on the criterion that the Regulatory Board of SIX Swiss Exchange uses when deciding whether to admit a security to listing on the exchange, thus setting a very high threshold before barring a buyback because of its influence on the free float. As the buyback also did not impact the control of Actelion Ltd, the Takeover Board found that both conditions were be satisfied in the case at hand and, thus, granted the exemption (TOB Decision 459/01 of 3 November 2010 in re Actelion Ltd).

This decision is, however, not so much interesting for what the Takeover Board considered than for what it did not examine namely compliance with corporate law. Under Swiss corporate law, as a matter of principle, a company is not allowed to repurchase more than 10% of its own shares. While the nature of this rule and its applicability to cases where the company intends to cancel the shares it acquires are the object of a controversy in the legal literature, the Takeover Board had in its Partners Group decision held that it would not allow a buyback if it did not comply with these rules and, in particular, if the issuer did not take the requisite corporate actions to cancel the shares before acquiring them (TOB Decision 408/01 of 2 April 2009 Partners Group Holding Ltd). This decision triggered in turn a heated debate on not only the substantive merits of this position but also on the institutional issues it raises. Indeed, whereas takeover regulations seek to protect investors and ensure the effectiveness of capital markets, corporate law and capital protection have first and foremost the interests of creditors at heart and are usually left to the courts to decide. Therefore, when the Takeover Board appointed itself as the arbiter of corporate law, not only did it venture into the remit of courts, it also took on itself to act as guardian of interests that are not germane to its own jurisdiction.

From this perspective, the Actelion decision marks a departure from the Partners Group decision, which was already announced in a previous decision (Decision 435/02 of 24 February 2010 Transocean Ltd.). Nevertheless, the rumors of the death of the Partners Group doctrine are probably widely exaggerated. While the Actelion Ltd decision does not expand on this issue, a closer look at the disclosure documents point out that Actelion Ltd had expressly conditioned any acquisition of shares in excess of 10% of the share capital to a decision of its general meeting, thus implicitly accepting to apply the Partners Group doctrine. Therefore, it remains to see whether the Takeover Board would accept to exempt a buyback which would not comply with this requirement. Nevertheless, the Actelion decision marks a departure from the Partners Group doctrine in terms of evidentiary requirements: If this decision acquires precedential value, compli-

ance with corporate law will no longer be tested by the Takeover Board in connection with buyback programs, but will be left to the remit of the ordinary courts.

3) Restructuring of a Convertible Note as a Buyback Program

Whereas the Actelion decision restricts the jurisdiction of the Takeover Board, another decision concerning Transocean Ltd. expanded it into the restructuring of convertible notes (TOB Decision 461/01 of 16 November 2010 in re Transocean Ltd.). Transocean Ltd., or more precisely its affiliate Transocean Inc., Cayman Islands, had issued in December 2007 three series of convertible notes for an aggregate amount of USD 6.6 billion. The notes were not listed in Switzerland or abroad, but merely traded on the OTC market.

In September 2010, Transocean Ltd. announced that it would issue a new preferred and secured bond and would use the proceeds to refinance the outstanding convertible bonds. It then solicited the Takeover Board to declare that a repurchase of the convertible notes at the option of the holders of any of the notes or by way of redemption would not constitute a public takeover and, simplifying, to exempt any public offer to acquire convertible notes under the Takeover Board Circular n° 1.

Considering this request, the Takeover Board tersely considered that a convertible bond is for the purpose of Swiss takeover law an equity security and a public tender offer for such securities is within the scope of Swiss takeover regulations. While this holding is consistent with several precedents (see, e.g., TOB Decision 419/01 of 18 August 2009 in re Petroplus Holdings Ltd), this is the first case where it is extended to convertibles that are neither listed on a Swiss exchange nor offered to all shareholders, but merely traded on the OTC market.

It then held that to the extent the provisions of the notes provide for an option of the holder to have its notes bought back or for a right of the issuer to redeem the security, the characteristic elements of an offer by a bidder which is subject to the acceptance of the investors were missing. Therefore, in both cases, the Takeover Board accepted to rule that the exercise of these rights granted at issuance would not constitute a tender offer.

By contrast, where the issuer publishes an offer to buy back convertible notes, the rules on share buybacks will apply irrespective of the embedded option to convert into shares being in or out of the money. In other words, for the Takeover Board, a convertible is always an equity instrument, even when the conversion right is worthless and is, in fact, comparable with straight bonds.

Considering its practical consequences, this decision is odd: It subjects to the jurisdiction of the Takeover Board a transaction in instruments that were not traded on an exchange and that are more like debt securities than shares. Admittedly, this quirkiness stems partly from the Stock Exchange Act, which provides that the takeover law applies to public tender offers for any equity security (listed or not) of a Swiss issuer whose equity securities are exclusively or partially listed on a Swiss exchange. Moreover the outcome, as such, does not raise any particular issue as the regime provided for by the Takeover Board Circular n° 1 focuses mainly (if not exclusively) on ensuring sufficient transparency and avoiding market abuses, rather than focusing on corporate issues which are characteristic of equity securities. Nevertheless it highlights the peculiarity of the buyback regime, which applies only to certain types of securities, although the need for transparency and fairness extend beyond the realm of shares and extend into the world of bonds and derivatives.

4) Inapplicability of Takeover Regulations to the Restructuring of an Employee Stock Option Plan

The odd conclusion resulting from the Transocean decision was, however, not extended to the restructuring of employee stock option plans. In the Basilea Pharmaceutica Ltd decision, the Takeover Board was called upon to consider an offer made by an issuer who intended to restructure employee stock options that had been granted to some 258 employees (TOB Decision 462/01 of 26 November 2010 in re Basilea Pharmaceutica Ltd).

The employees had the choice to either keep their existing options or accept to waive them and receive new options with a higher strike price and a longer maturity in exchange. In other words, structurally this transaction was not much more different from similar instances where an issuer sought to restructure its capital or its holding structure through a tender offer. Moreover, as the Transocean decision pointed out, Swiss takeover law applies to any public tender offer for equity securities, regardless whether they are listed or not, provided the issuer has listed at least a part of its equity securities on a Swiss exchange.

Nevertheless, the Takeover Board held that the term equity securities (or more precisely "Beteiligungspapiere" or "titres de participation") implied that the equity securities would qualify as securities under the Stock Exchange Act (SESTA), namely standardized instruments that are appropriate for mass-trading. On that basis, it considered that while the terms of the employee options were standardized, the instruments were expressly designed not to be traded or assigned by their holder. Interestingly, the Takeover Board considered that they were therefore issued for a specific person and did not qualify as securities. Consequently, restructuring of an option plan does not qualify as a tender offer.

The Takeover Board specified clearly, however, that this holding does not limit the line of precedents, which held that restructuring an option plan during (and, considering the practice of the Takeover Board with regard to cross-conditionality, more accurately in connection with) a friendly tender offer is deemed to be an acquisition of shares during a tender offer, which triggers the best price rule and may not be made at preferable terms than the one of the public tender offer (see, e.g., the TOB decision 378/02 of 20 January 2009 in re Speedel Holding Ltd, c. 2). In other words, restructuring a stock option plan is not a tender offer, because options are not equity securities, but restructuring them during a tender offer is an acquisition of equity securities for the purpose of the best price rule.

This conclusion is not as paradoxical as it may seem at first glance. Once we recast the regulation of buybacks as a regulation of market abuse as opposed to the regulation of control transactions, which is usually the ambit of takeover regulations, the distinction makes sense: While the restructuring of stock option plans can have an impact on the control of company, it will not impact the market for the shares generally or lead to any abusive transaction detrimental to public investors (other than the employees). Therefore, they do not need to be regulated. At the same time, in control transaction mode, they are relevant: Restructuring a stock option plan during a tender offer can be a pretext to pay a premium to certain shareholders, in contradiction with the affirmed purpose of takeover regulations.

5) Takeover Regulation of Buybacks as Regulation of Market Abuse

In conclusion, these three recent decisions of the Takeover Board highlight how the special regime applicable to buybacks under Swiss takeover law has moved away from corporate law and control transactions to focus on ensuring effective securities markets. The Actelion Ltd decision marks apparently a departure from a focus on corporate law and creditor protection towards an approach considering whether markets for the securities that are bought back will be impaired. The Transocean decision regulates repurchases of notes, provided the instruments are convertible into shares even if the conversion right is deep out of the money. Finally, the Basilea Pharmaceutica Ltd decision points out that when regulating repurchase agreements, “security” rather than “equity” is the operational term to define the scope of the regulation, inspite of the general approach when dealing with tender offers.

None of these decisions are per se questionable or unfounded. They do, however, show that the regulation of buybacks is not really the regulation of tender offers, at least in the Swiss approach which places the emphasis on the corporate dimension of the transactions, but rather a subspecies of market abuse regulation. This approach, as a matter of fact, is entirely consistent with the one prevailing in the European Union where the Market Abuse Directive is the basis for the regulation of buybacks in the Commission Regulation (EC) 2273/2003 of 22 December 2003 implementing Direc-

tive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buyback programs and stabilization of financial instruments and, even in the United States, where the regulation of tender offers applies to all offers for securities, without limiting its scope to shares or takeovers.

Nevertheless, it is far from obvious that the regulation of market abuse should lie within the ambit of the Takeover Board, as opposed to the Swiss Financial Markets Supervisory Authority FINMA, or why this type of transactions should be regulated extensively, whereas arguably more harmful forms of market abuse, such as certain manipulative practices are out of the reach of the regulators. Undoubtedly, this conclusion stems from a strange opportunity offered by the regulation of takeovers. However, the inconsistency undermines the legal edifice and, more importantly for the practitioner, makes the scale and scope of the buyback regime more difficult to determine without involving the regulator as these three decisions also point out.

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FINMA Addresses Legal and Reputational Risks in Cross-Border Financial Services

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In mid-October 2010 the Swiss Financial Market Supervisory Authority FINMA (FINMA) issued a new position paper addressing the risks in cross-border financial services. It discusses the legal and reputational risks associated with cross-border financial services and calls on banks and other regulated asset managers to establish compliance with foreign supervisory law and to define appropriate business models in each target market. The position paper puts a significant burden on banks and other regulated financial services provider in establishing appropriate procedures.

By René Bösch

The "Swiss banking" and "Swiss wealth management" models are destined to focus on cross-border services for private clients who reside outside of Switzerland. With this focus Swiss banks and asset managers gained significant market share in the wealth management but at the same time became more and more exposed to legal and reputational risks that are associated with cross-border financial services. Over the years certain Swiss based financial institutions have been involved in significant legal and regulatory proceedings outside of Switzerland in connection with their services to residents of the relevant country or certain alleged business practices. The risks arising from serving clients in other jurisdictions include risks associated with the cross-border provision of financial services and the cross-border sale and promotion of financial products.

In its position paper on risks in cross-border financial services published on 22 October 2010 (Position Paper) FINMA discusses these risks and formulates its expectation of how regulated institutions in Switzerland have to address and manage these risks. FINMA holds that the disregard of foreign rules may have implications under Swiss law and therefore FINMA expects the institutions supervised by it to duly observe foreign supervisory legislation. The Position Paper marks the first instance where FINMA so explicitly addresses the compliance with foreign supervisory legislation by Swiss banks and other licensed asset managers, and it is quite significant that FINMA now promulgates clear guidelines as to how supervised institutions have to establish such compliance.

Before addressing its own views as to the required conduct by financial institutions in relation to the cross-border business, FINMA discusses the particular risks that can be associated with the cross-border business. FINMA notes that the laws of many jurisdictions provide for broad licensing or other approval requirements if financial services are addressed to citizens or residents of that specific country, which approach to regulation is largely in contrast to Swiss financial market regulation. Particularly, the Position Paper highlights that while certain activities such as socializing may still be permissible, other activities such as cold calls, investments services or marketing activities are subject to approval or licensing requirements in various countries. FINMA also points to the fact that certain products are subject to specific regulation (including in particular insurance regulation) and must therefore not be offered to residents of many countries. FINMA then goes on to describe risks associated in connection with tax and criminal laws, in particular those associated with tax evasion or tax fraud. On that basis FINMA concludes that under existing laws there is no provision that specifically requires supervised institutions to comply with foreign laws. However, the general duty of supervised institutions to assure a proper business conduct must, in the eyes of FINMA, at least in the future be interpreted in such a way that such assurance must also extend to the compliance with foreign supervisory legislation.

As a consequence FINMA now stipulates that supervised institutions are required to conduct a thorough assessment of the legal framework and the risks associated with their current cross-border business. Supervised institutions must identify all of their target markets and then ascertain and verify the rules applicable to them when transacting business in those markets (this exercise could be paraphrased as the "know-your-markets'-regulation" exercise). In a second step suitable measures to mitigate or eliminate risks must be taken. This will require the establishment, promulgation and regular update of clear guidelines and directives as to the conduct of business in the target markets, as well as the education and training of the personnel that is involved in servicing these markets. Furthermore, supervised institutions are bound to establish effective compliance procedures through which the compliance by the institutions' personnel with the guidelines and directives regarding the transaction of cross-border

business must be supervised. Finally, the supervised institution's organisation must provide for the ordering of sanctions in relation to breaches of those guidelines.

It is a phenomenon of the Swiss wealth management market that a significant amount of wealth management services are provided through independent asset managers that are not subject to prudential supervision. Addressing this phenomenon FINMA also stipulated that it does not regard the outsourcing of the management of client relationship's to external asset managers as effective means of mitigation or eliminating the risks of supervised institutions. Rather it expects the supervised institutions to also address the risks potentially generated by external asset managers and other service providers.

FINMA furthermore addresses the business of banks, broker dealers and asset managers with insurance wrappers that are provided by other parties. It also specifically stipulates that insurers with business models involving insurance wrappers have to comply with their supervisory responsibilities to discharge their identification obligations.

FINMA made clear that it will increasingly focus on the conduct of supervised institutions in their cross-border operations and will systematically monitor the implementation of the assessment process and related measures by institutions. It also made abundantly clear that it regards the compliance with FINMA's "expectations" with regard to the processes and measures outlined in the Position Paper as part the general duty of financial institutions to assure a proper business conduct, and that it will give high degree of focus on this element in its future enforcement policy.

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EU Regulation on Credit Rating Agencies

Reference: CapLaw-2010-67

Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (CRA Regulation) entered into force on 7 December 2009. The obligation under the CRA Regulation to use credit ratings for regulatory purposes only if they are issued by credit rating agencies (CRAs) established in the EU and registered under the CRA Regulation came into effect on 7 December 2010. This article discusses such obligation and other key aspects of the CRA Regulation and its impact from a Swiss perspective.

By Olivier Favre / Jan Blöchliger

1) Overview

The CRA Regulation introduced in the EU a mandatory registration process and supervision regime for CRAs operating in the EU and legislation for what used to be the subject matter of voluntary codes of conduct. The provisions of the CRA Regulation are directly enforceable in each member state of the EU.

The CRA Regulation applies to credit ratings issued by CRAs registered in the EU under the CRA Regulation and which are disclosed publically or distributed by subscription. For the purposes of the CRA Regulation, a credit rating is an opinion regarding the creditworthiness of an entity, a debt or financial obligation, a debt security, a preferred share or other financial instrument, or of an issuer of any such securities or other rights, provided that such credit rating is issued using an established and defined ranking system of rating categories. Certain types of ratings are excluded from the scope of the regulation, for instance, (i) private credit ratings not intended for public disclosure or distribution and (ii) certain credit ratings prepared by central banks.

The CRA Regulation establishes a mechanism for a CRA to be registered with the competent authorities of its home member state (*i.e.* the EU state, where the CRA has its registered office). In order to be registered, a CRA must submit its application to the Committee of European Securities Regulators (CESR) which then, in turn, liaises with the competent authorities of such CRA's home member state and the competent authorities of other member states where the CRA operates in (CRAs operating in the EU before 7 June 2010 had to submit their application by 7 September 2010). Where a group of CRAs should be registered, the CRA Regulation establishes a process of joint registration for all group members. A registration of a CRA under the CRA Regulation is published by the European Commission and effective within the entire EU.

Supervision over a CRA under the CRA Regulation is carried out by the competent authorities of the relevant home member state in co-operation with the relevant authorities of the other member states, where the CRA operates in. The supervision powers aim at ensuring that a CRA complies with its obligations under the CRA Regulation. However, the authorities are not permitted to interfere with the content of credit ratings or the methodologies used by a CRA.

In Switzerland, by comparison, the Swiss Financial Market Supervisory Authority FINMA (FINMA) can "recognise" CRAs for purposes of the Swiss Federal Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Dealers if they satisfy certain minimum standards (such "recognition" occurs on the basis of article 52 of such Ordinance and FINMA-Circular 2008/26 on Rating Agencies). As of now, however, CRAs "recognised" by FINMA are not subject to permanent supervision or periodic inspection by FINMA.

2) Obligation under the CRA Regulation to Use Ratings of Registered CRAs

Pursuant to article 4(1) of the CRA Regulation, with effect as from 7 December 2010:

- credit institutions, investment firms (pursuant to MiFID), certain insurance and reinsurance companies, undertakings for collective investment in transferable securities (UCITS) and institutions for occupational retirement provisions (each as defined in the relevant EU-Directives) may use credit ratings for "regulatory purposes" (defined as the use of credit ratings for the specific purpose of complying with EU law, as implemented by the national legislation of the EU member states) only if such credit ratings are issued by CRAs established in the EU and registered pursuant to the CRA Regulation (e.g. where a credit institution relies on credit ratings of a CRA for the purpose of applying risk weights for regulatory capital purposes under the EU Capital Requirements Directive, the CRA must be registered pursuant to the CRA Regulation and meet its requirements); and
- where a prospectus published under the EU Prospectus Directive contains a reference to a credit rating, the issuer, offeror, or person asking for admission to trading on a regulated market must ensure that the prospectus also includes clear and prominent information stating whether or not such credit ratings are issued by a CRA established in the EU and registered pursuant to the CRA Regulation.

Credit ratings issued by an entity outside the EU may be used for the purposes of the CRA Regulation if the conditions of the endorsement regime (set out under (3) below) or the equivalence regime (set out under (4) below) are met, as if they were credit ratings issued by a CRA established in the EU and registered under the CRA Regulation.

3) Endorsement Regime

A CRA registered under the CRA Regulation can endorse pursuant to article 4(3) of the CRA Regulation the credit ratings of entities or instruments given by their group affiliates outside of the EU provided that, inter alia, (i) the third country affiliate operates under a no-less-stringent supervisory regime than the one in the EU, (ii) there is an objective reason for the rating to be performed in the third country rather than within the EU, (iii) the affiliate established in the third country is duly authorised or registered and subject to supervision in such country and (iv) the regulatory regime in the third country prevents interference by the competent authorities and other public authorities of that third country with the content of credit ratings and methodologies.

4) Equivalence Regime

Where credit ratings issued by a non-EU CRA relate to entities established, or financial instruments issued, in non-EU countries, such credit ratings may be used for the purposes of article 4(1) of the CRA Regulation (without being endorsed pursuant to (3) above) if such credit ratings are recognised based on equivalence pursuant to article 5 of the CRA Regulation. This requires that:

- the non-EU CRA has been certified pursuant to the process specified under article 5(2);
- the non-EU CRA is authorised or registered in such third country and it is subject to supervision in such third country;
- the European Commission has adopted an equivalence decision confirming that the standards of regulation in the relevant third country are equivalent to EU standards (which requires, inter alia, that CRAs in the third country must be subject to legally binding rules which are at least equivalent to those set out in articles 6 to 12 and Annex I of the CRA Regulation covering, for instance, the management of conflicts of interest and the organisational processes and procedures that a CRA needs to have in place);
- a co-operation agreement has been entered into with the third country regulator concerned (such agreement must at least specify (i) the mechanism for the exchange of information between the competent authorities and (ii) the procedures concerning the coordination of supervisory activities); and
- the credit ratings issued by the non-EU CRA and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more EU member states.

5) Governance Requirements for CRAs

Under the CRA Regulation, CRAs registered under the CRA Regulation must comply with certain governance requirements (e.g. organisational and operational requirements pursuant to Section A and B of Annex I of the CRA Regulation). Such rules aim at increasing the independence of CRAs and avoiding conflicts of interest. Moreover, the CRA Regulation also requires that a CRA complies with certain disclosure requirements (e.g. the obligation to disclose the methodologies, models and key rating assumptions it uses to issue credit ratings).

6) Structured Finance Instruments

As regards structured finance instruments (such as a financial instrument resulting from a securitisation transaction), the CRA Regulation provides that credit ratings for such structured finance instruments have an additional symbol to distinguish them from other types of credit ratings. Moreover, CRAs are also required to comply with specific disclosure requirements for structured finance instruments (e.g. the obligation to disclose information about the due diligence processes they have performed).

7) Impact from a Swiss Perspective

From a Swiss perspective, the CRA Regulation will be relevant for instance as regards the following:

- where a Swiss issuer offers securities to investors in the EU falling under the scope of article 4(1) of the CRA Regulation, such investors will have to ensure the relevant credit ratings comply with the requirements of the CRA Regulation, if such ratings are used for "regulatory purposes";
- to the extent that a Swiss issuer prepares a prospectus for the EU capital markets under the EU Prospectus Directive and a reference to a credit rating is included in such prospectus, it must be stated whether or not such credit ratings are issued by a CRA established in the EU and registered pursuant to the CRA Regulation;
- EU group affiliates of Swiss entities falling under the scope of article 4(1) of the CRA Regulation must comply with the requirements of the CRA Regulation when using credit ratings for "regulatory purposes"; and
- where a credit rating is issued by a CRA established in Switzerland that is not an affiliate of a CRA registered under the CRA Regulation, the question may arise under what conditions such credit ratings can be used under the CRA Regulation on the basis of the equivalence regime (as set out under (4) above) (to our knowledge, there are at present no Swiss affiliates of CRAs operating in the EU under the CRA Regulation that issue credit ratings in Switzerland that could be endorsed on the basis of the endorsement regime).

8) Outlook

The CRA Regulation is currently under review in various respects.

In June 2010, a legislative proposal amending the CRA Regulation was adopted by the European Commission. One key proposal is that the new European Securities and Markets Authority (ESMA) would be entrusted with powers currently lying with the home regulators of the relevant member states, in order to streamline the registration process and establish a more efficient supervision.

Also, in order to align the CRA Regulation with the new proposal for a Directive on Alternative Investment Fund Managers (AIFMD), alternative investment funds would be included in article 4(1) of the CRA Regulation as one of the entities that are subject to the obligation to use only credit ratings of CRAs established in the EU and registered under the CRA Regulation.

Furthermore, in November of 2010, the European Commission launched a new public consultation on the need for possible further regulation dealing, inter alia, with potential risks arising from over-reliance on credit rating by financial markets participants, the high degree of concentration in the rating market, the need to introduce a civil liability regime for CRAs in the CRA Regulation and conflicts of interest due to the remuneration models used by CRAs (e.g. move away from an "issuer-pays" model for fees of CRAs).

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Federal Criminal Court's Decision on Vekselberg et al. regarding OC Oerlikon and Acting in Concert

Reference: CapLaw-2010-68

On 21 September and 20 October 2010, respectively, the Swiss Federal Criminal Court *(Bundesstrafgericht)* in Bellinzona issued its decisions on the alleged violation of Swiss disclosure rules by Mr. Vekselberg, Mr. Pecik, Mr. Stumpf and Mr. Stadelhofer. When deciding that the defendants are not guilty, in its considerations, the court also tried to clarify some aspects of Swiss disclosure law.

By Benjamin Leisinger

On 21 September and 20 October 2010 the Swiss Federal Criminal Court (FCC) issued its judgments on the alleged violation of Swiss disclosure rules by Mr. Vekselberg and others holding that they are not guilty.

The alleged violation of article 20 and article 41(1)(a) of the Stock Exchange Act (SESTA) by the defendants was based on the allegation that these persons failed to disclose that they acted in concert. Under Swiss disclosure law, persons acting in concert with respect to the direct or indirect acquisition or sale of equity securities of a Swiss listed company or the exercise of voting rights in such equity securities are subject to an obligation to disclose this fact. The disclosure must be made to the respective company and the stock exchange. If such notice is not given within the period of four trading days after the fact leading to the disclosure duty, article 41 SESTA sanctions this with a fine (since 1 January 2009 also in cases of negligence). The potential fine can be considerable: in cases of intentional breaches of the duty to disclose, the

fine can be up to double the purchase price or sale proceeds, calculated on the basis of the difference between the new shareholding and the last shareholding disclosed. In cases of negligence, the fine can be up to CHF 1,000,000.

In its decision, the FCC tried to clarify the term "acting in concert" pursuant to article 20(3) SESTA and article 15 of the former Ordinance of the Federal Banking Commission of Stock Exchanges and Securities Trading (now article 10 of the Ordinance of the Swiss Financial Market Supervisory Authority FINMA on Stock Exchanges and Securities Trading, SESTO-FINMA). With respect to the understanding of the term "acting in concert", the FCC repeated that ***mere parallel behavior does not lead to a disclosure obligation.*** Only in cases of a certain intensity of the relationship between the parties, *i.e.,* where there is a ***minimal external organization and a minimal internal common goal or focus*** *(minimale innere Finalität und äussere Organisiertheit),* a group for Swiss disclosure purposes actually exists.

The FCC clarified that a sales contract with respect to relevant equity securities does not lead to a group between the seller and the buyer. Only where specific additional agreements *(Nebenabreden)* exist, an acting in concert might be at hand, depending on the nature of such agreements.

When emphasizing the certain intensity required for the constitution of a group, the FCC made a potentially dangerous statement: it held that also ***factual groups (faktischer Zusammenschluss)*** of companies or persons could be interesting to potential investors where there is sufficient intensity regarding the joint interest and organization and, due to the aim to have full transparency, could lead to a relevant acting in concert and a disclosure duty. Whether or not the agreements are binding, according to the FCC, is of secondary relevance. In the author's view, this is a problematic consideration. Only where the individual members subordinate their individual interests in their shares under the joint interests of the group, acting in concert maybe at hand rather than parallel behavior. Where the individual members only do what they individually think is in their best own interest (even if that may entail supporting someone else's behaviors) and are not bound in whatever way, no group exists. Also in cases of gentlemen agreements, which are held to lead to acting in concert by some authors, the violation of the "agreement" would lead to social (rather than legal) consequences and the parties may to a certain degree be "bound" by the common agreement. But, where the parties simply express their views and envisaged future behavior but in no way legally or socially bind themselves to act accordingly in the future, no acting in concert should be assumed. This understanding would also be in line with the FCC's clarification that, contrary to the Federal Finance Department's view, the mere existence of the same interests as a shareholder *(gleichlaufende Aktionärsinteressen)* is of no relevance under article 20 SESTA.

The FCC further stated that certain agreements with respect to the exercise of votings rights are commonly seen in practice and are of no relevance. In particular, the coordination with respect to the election of specific members of the board of directors, according to the FCC, should be irrelevant. In the FCC's opinion, only when the commonly elected member of the board then coordinates his voting in the board meetings with the relevant shareholders or other board members, a relevant acting in concert would exist. The author agrees that contacting important shareholders with respect to prospective board members and convincing them that this is a qualified candidate is regularly seen and should not be relevant. In such a situation, the individual shareholders then still act in their own best interest and would not vote in favor of the board member if they consider him or her not suitable. A mere formation of opinion among shareholders or coalition building for a particular resolution must be possible without triggering disclosure obligations.

However, careful investors will be prudent to refrain from too intense contacts and discussions with other shareholders with respect to the voting at shareholders' meetings.

The FCC's decision addressed some so far unanswered questions in Swiss disclosure law. But, investors will still always have to carefully analyze the legal questions and consequences arising in the context of transactions or agreements directly or indirectly concerning the equity securities of Swiss companies (at least partially) listed in Switzerland.

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gategroup Holding AG raises CHF 252 Million in Rights Offering

Reference: CapLaw-2010-69

On 9 November 2010, gategroup Holding AG, having its shares listed on the SIX Swiss Exchange, successfully completed a CHF 252 million capital increase (including over-allotment shares) based on an issue price of CHF 43 per new share by way of a rights offering to its shareholders. In the rights offering, 2,977,645 new shares were subscribed for by existing shareholders, while 2,123,236 new shares were purchased in the global offering. A banking syndicate led by Credit Suisse as Global Coordinator and Goldman Sachs International assisted in this transaction. The over-allotment option granted to the banking syndicate has been exercised in full.

CVC Capital Partners and TDC A/S Announce Completion of Sunrise Transaction

Reference: CapLaw-2010-70

CVC Capital Partners announced on 28 October 2010 the successful completion of the CHF 3.3 billion acquisition of Sunrise Communications AG from Danish telecom group TDC A/S, probably the largest private equity financing in Europe in 2010. The financing included an approximately CHF 1.5 billion (equivalent) high yield senior secured and senior notes financing as well as senior credit facilities of more than CHF 800 million. Clearance of the transaction from the Swiss Competition Commission, the Federal Office of Communications and the Federal Communications Commission ComCom has been received end of October 2010 whereupon the transaction closed successfully.

Credit Suisse AG Covered Bond Programme

Reference: CapLaw-2010-71

On 22 November 2010, Credit Suisse AG (Credit Suisse) established its EUR 15 billion Covered Bond Programme, issues under which will be irrevocably guaranteed as to payments by Credit Suisse Hypotheken AG, and on 1 December 2010, Credit Suisse executed its debut issue of EUR 1.25 billion Fixed Rate Covered Bonds due 1 December 2015 thereunder. The Covered Bonds are indirectly backed by a portfolio of mortgages from Credit Suisse's domestic mortgage pool.

SCHMOLZ+BICKENBACH KG Successfully Sold 12.9 Million Rights of SCHMOLZ+BICKENBACH AG in an Accelerated Bookbuilding

Reference: CapLaw-2010-72

SCHMOLZ+BICKENBACH AG announced on 2 November 2010 that its affiliated companies have sold 12,862,053 rights of SCHMOLZ+BICKENBACH AG for a price of CHF 4.45 per right in an accelerated bookbuilding in the context of the CHF 297 million rights issue of SCHMOLZ+BICKENBACH AG. Credit Suisse acted as Sole Global Coordinator, and together with COMMERZBANK, The Royal Bank of Scotland and WestLB AG as Joint Bookrunners on the transaction. In the rights offering, 75,000,000 new shares with a nominal value of CHF 3.50 each were offered to existing shareholders at an issue price of CHF 3.97 per offered shares. Subscription

rights for 74,821,900 new shares had been validly exercised, representing approximately 99.76% of the new shares offered to existing shareholders.

Peach Property Group AG Successfully Completes Initial Public Offering

Reference: CapLaw-2010-73

Peach Property Group AG listed its shares on the SIX Swiss Exchange according to the Main Standard on 12 November 2010. In the initial public offering, 1,725,000 newly issued shares and 289,000 secondary shares (excluding over-allotment option) were offered at the offer price of CHF 32. Based on the opening price of CHF 33, Peach Property Group AG was valued approximately CHF 160 million on the first day of trading. Bank am Bellevue acted as Global Co-ordinator, Sole Bookrunner and Lead Manager.

Conference on Private Equity—Contracts and Legal Issues in Connection with Venture Capital Investments (Private Equity – Verträge und Rechtsfragen bei Venture Capital Investments)

Wednesday, 26 January 2011, 09.00-16.50
Kongresshaus Zurich, Zurich

www.eiz.uzh.ch

Capital Market Transactions VI—Conference Report

On 25 November 2010, the annual conference of the Europa Institute at the University of Zurich on capital market transactions *(Kapitalmarkttransaktionen)* took place again for the sixth time. The conference was chaired by Thomas Reutter of Bär & Karrer AG and Thomas Werlen of Novartis AG.

The conference's topics ranged from the specificities of block trades to new financial markets instruments, so called contingent capital bonds, and the feasibility to issue them even under the existing law. Other interesting topics were hedge fund regulation, subscription rights in case of capital increases, public buy-backs of own shares, new

developments in Swiss disclosure law and securities lending and borrowing between professional market participants under master agreements.

After an introduction by Thomas Reutter, Matthias Wolf, the first speaker, started by explaining the issues arising in cases of block trades. He differentiated between block trades and other ways to sell a considerable number of shares, such as by a marketed offering. He showed how the involved parties, *i.e.,* the seller and the investment banks, can allocate the risk of the placement being successful by choosing between different transactions structures (best effort versus agreement on a backstop price or agreement on a bought deal). He continued by showing how a block trade would typically take place. Further, Mr. Wolf explained that, under Swiss law, due to its nature of a secondary offering, a prospectus would not have to be in place but that voluntarily drafted marketing materials may still qualify as a prospectus-like document and could, therefore, still lead to prospectus liability in the individual case. Mr. Wolf also guided through the typical elements and clauses seen in placement agreements or block trade agreements, respectively. He pursued by explaining how the issuer of the shares can be involved in a block trade of an investor and the potential problems that could arise in this context. Finally, Mr. Wolf pointed out the regulatory issues that could also be important to block trade transactions, *e.g.,* Swiss disclosure duties under the Stock Exchange Act (SESTA), regulation prohibiting insider dealing, ad hoc rules of the stock exchange and also existing rules on market abuse.

The second speaker, Thomas Reutter, explained the concept of contingent capital. Contingent capital is commonly understood as a financing or capital increase that is contingent upon the occurrence of a specific predetermined event, also referred to as "triggers". Capital market instruments recently discussed in connection with contingent capital are so-called contingent convertible bonds. There, the triggers typically refer to events such as falling below a regulatory common equity ratio, the occurrence of which leads to a conversion. In contrast to existing convertible bonds, the investor generally has no call option, *i.e.,* no right to request conversion of the instrument. In his presentation, Thomas Reutter presented different possible structures and precedents (*e.g.,* Lloyds) of contingent capital instruments. He differentiated between contingent debt and contingent equity and between funded structures and unfunded structures. While funded structures, for example, do not increase the liquidity of the issuer but rather increase the capitalization, *e.g.,* by conversion of debt into equity, unfunded structures usually specifically serve the purpose of increasing the liquidity and of providing for tailored financing. In cases of contingent equity, Thomas Reutter showed how the shares that are required for the successful conversion of the contingent equity instrument could by created. He convincingly showed that, even under present law, contingent equity instruments could be structured and the shares could be issued from the conditional capital or the authorized capital presently known in Swiss law. However,

he also pointed to the limits of such structures, *e.g.* the limitation of the amount of the possible capital increase. He concluded by presenting the concepts of "reserve capital" *(Vorratskapital)* and of "convertible capital" *(Wandlungskapital)* presented by the Committee of Experts on "too big to fail" that has been appointed by the Swiss Federal Council to examine ways of limiting economic risks posed by large companies, and identified some interesting aspects that have yet to be addressed in order to ensure that the envisaged concepts meet the expectations and the desired purpose.

The next speaker, Markus Pfenninger, gave a lecture on the regulation of hedge funds in Switzerland and the European Union. He discussed the nature and (lack of a clear) definition of hedge funds and compared the myths surrounding hedge funds with the identifiable facts. He then continued by outlining the regulatory environment that hedge funds face in Switzerland, ranging from rules on distribution activities to organizational restrictions or taxation. Markus Pfenninger concluded by presenting the legislative developments in the European Union, in particular the Directive of the European Parliament and of the Council on Alternative Investment Fund Managers.

Andreas Neumann's contribution focused on capital increases and subscription rights. In the beginning, he showed the impact of the financial crisis on the typical structure of balance sheets. He also presented interesting data on the timing, volumes and application of funds from capital increases and on the sources of the capital increases, *i.e.,* whether the shares were issued out of companies' conditional or authorized capital. Andreas Neumann then turned to the shareholders' perspective and the data on capital increases with and without an exclusion of subscription rights. Amongst others, he showed that in 49% of the capital increases between 1 January 2004 and 30 June 2010 the subscription rights were not excluded and a trade in subscription rights took place. In 65% of the capital increases the capital increase happened at a discount, *i.e.,* at a price of more than 5% below the market price. In rare cases, the discount was more than 60%, mainly due to transactions in connection with restructurings.

Hansjürg Appenzeller presented new developments with respect to share buy-backs. He presented data on the number of share buy-backs between the year 2001 and October 2010. Further, Hansjürg Appenzeller outlined the most common manifestations of share buy-backs, *i.e.,* via the ordinary trading line, a second trading line and via put options. He discussed the purpose, execution and pricing of the different methods and evaluated them. Then he turned to the Circular No. 1 on buyback programmes of the Swiss Takeover Board (TOB) and compared it to the TOB's Communication no. 1 on the buyback of own shares. After that, Hansjürg Appenzeller showed how the actual buy-back of shares can be delegated to third parties and explained new developments of buy-backs, *e.g.,* buy-backs via a virtual second trading line.

Noel Bieri of SIX Exchange Regulation gave a lecture on practical aspects of the revised Swiss disclosure law. After explaining the purpose of Swiss disclosure duties and the main aspects of the revised disclosure law, he focused on the definition of financial instruments within the meaning of article 15 of the FINMA Ordinance on Stock Exchanges and Securities Trading (SESTO-FINMA). He showed cases where banks, for example, guaranteed a minimum price to the seller in connection with the placement of shares and would have benefited from a sale at a higher price, and explained why a financial instrument within the meaning of article 15 SESTO-FINMA was held to exist. Further, *inter alia,* Mr. Bieri clarified when disclosure duties arise in cases of financial instruments relating to a basket of shares. He stated that where there is no predominant likeliness that a specific underlying will or can be delivered to the holder of the instrument, no disclosure obligation exists. This analysis will have to be made at the time of issuing the product and must be repeated if the basket changes. Mr. Bieri also discussed disclosure obligations in case of securities lending in a chain of several persons or entities. He explained that the double reporting resulting from the current regulation is a concession to practicability of the disclosure regime. Finally, Mr. Bieri stated that in cases of granting of security rights pursuant to the Swiss Intermediated Securities Act, the security rights not leading to a transfer of the full legal title in the intermediated securities should be treated in analogy to the granting of a pledge, *i.e.,* do not trigger a disclosure obligation at the time they are granted.

Finally, Urs Pulver presented selected issues with respect to securities lending and borrowing. He explained the master agreements typically used in an international context, *e.g.,* the Global Master Securities Lending Agreement (GMSLA). Moreover, he discussed the feature of close-out netting and the admissibility under Swiss private law and Swiss insolvency law. He reasoned that close-out netting is possible and generally valid also from a Swiss insolvency law perspective, but that the parties should opt for automatic early termination in order to increase the robustness under Swiss insolvency law. Urs Pulver concluded by presenting lessons learned from the financial crisis, *e.g.,* the necessity to update older master agreements and the increased importance of risk awareness.

All those who are interested in the details of the conference will be glad to hear that, as usual, the speeches given at the conference will also be published.

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