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Insurance Supervision Act – Key Aspects of the Ongoing Revision

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From mid November 2018 until 28 February 2019, the Swiss Federal Council held consultations on a partial revision of the Insurance Supervision Act (ISA). Subject to completion of the legislative process and the referendum period, the revisions will likely enter into force around 2022.

The proposed bill will update existing provisions in the ISA to bring them in line with international standards and rectify perceived inadequacies in the current regulations. It will also introduce completely new provisions to regulate the restructuring of (re)insurance companies, an explicit statutory basis for the Swiss Solvency Test (SST), product governance and conduct-of-business regulations for specific investment products and, last but not least, a system of differentiated supervisory intensity to better reflect the specificities of the retail/wholesale and professional insurance markets.

By Petra Ginter[1]

1) Introduction

The Insurance Supervision Act (ISA) has regulated Swiss (re)insurance companies and insurance brokers on a Federal level since 2006. Since then, it has seen only minor amendments. The partial revision that the Swiss Federal Council published for consultation in November 2018 aims to implement regulatory developments in the insurance as well as financial sector of the recent years into the insurance regulations.

Restructuring Framework

Firstly, new provisions on the restructuring of (re)insurance companies shall be introduced. The aim is to be able to restructure (re)insurance companies in the event of financial distress. Under the current law, the Swiss Financial Market Supervisory Authority FINMA (FINMA), as the responsible regulator and authority to initiate insolvency proceedings against Swiss based (re)insurance companies (and certain non-regulated substantial group companies within a FINMA supervised (re)insurance group), only has the option to liquidate such companies directly. The proposed new restructuring regime will close this gap for (re)insurance companies which are currently the only companies under Swiss law for which a restructuring is not available. In addition, by adequately implementing international standards, it aims to improve the protection of the insureds and further supports the reputation of Switzerland as (re)insurance market.

Differentiated Supervisory Intensity

Secondly, a new client categorisation shall be introduced and serve as benchmark for the respective level of prudential supervision. Insurance companies that only deal with professional clients shall benefit from lighter supervisory requirements, such as the release to hold tied assets as coverage for insurance claims. Besides the new client categorisation, the proposed rules include additional elements of deregulation. For example, companies with particularly innovative business models shall be exempted from supervision completely if the rights of the insureds are sufficiently protected. The aim of such deregulation measures is to give (re)insurance companies more flexibility in the use of financial resources and strengthen the Swiss financial centre.

Conduct-of-Business and Product Governance Regulation for Investment Products

Thirdly, similar to the conduct rules for financial service providers under the new Financial Services Act (FinSA), which do not directly apply to (re)insurance companies, the draft bill contains specific rules of conduct for specified insurance products.

The following paragraph provides more detailed information on the key aspects of the various proposals. It also indicates where the industry is no amenable to the proposed provisions and has provided counter-proposals during the consultation period.

2) Key Aspects of the Revision

a) Introduction of a Restructuring Framework (Draft article 52a-article 52m)

The current ISA does not contain provisions on the restructuring of a (re)insurance company. At the same time, ISA explicitly pre-empts operation of the otherwise applicable restructuring provisions in the Debt Collection and Bankruptcy Act. This has resulted in considerable legal uncertainty on how FINMA as the competent authority would be entitled to proceed to protect the interests of the insureds.

In many hypotheticals, the interests of the insureds are best served by keeping their (re)insurer operating as a going concern rather than by proceeding to a liquidation. Life and health insurance policies are a case in point. Aside from the theoretical and practical difficulties of a close-out valuation of insurance policies, early termination of life and health policies may result in the insureds effectively losing cover altogether. Upon liquidation of the insurer, it may be difficult if not impossible for the insureds or for members of the former collective to obtain replacement cover at reasonable rates: the equivalence principle may lead to substantial increases in premiums, and existing illnesses or age may further result in exclusions/reservations of cover.

The current regulatory framework is insufficient to account for the interests of the insureds: article 51 conditions FINMA's authority to issue protective measures on the failure of the (re)insurer to comply with regulatory requirements or a determination that insureds' interests are compromised. Within the (non-exclusive) list of possible protective measures, article 51 (2) (d) explicitly provides for the possibility to transfer an insurance portfolio to another insurance company. This list does not contain other important tools that are commonly deployed in a restructuring context, such as capital measures or the possibility to intervene into the rights of third parties.

Against this background, it is appropriate that sector-specific statutory insurance regulation equips FINMA with a comprehensive toolkit.

The proposed restructuring regime includes procedural as well as substantive provisions. The procedural provisions provide the legal basis for FINMA to order different steps in the restructuring procedures and to issue the associated delegated legislation. The substantive provisions specify various restructuring measures, such as:

– the transfer of a (re)insurance portfolio to another (re)insurer or rescue company (*Auffanggesellschaft*);

– the continuation of the (re)insurance portfolio within the existing carrier with the right to intervene into the rights of the creditors;

– the reduction and subsequent increase of the share capital; or

– the conversion of specific debt into equity rights (bail-in).

When ordering restructuring measures, FINMA must ensure that no creditor will be worse off than he/she would be treated in the bankruptcy (so-called "no creditor worse off than in liquidation" principle). The proposed bill also alters the (re)insurance creditor hierarchy: It introduces a new creditor class to rank between the privileged creditors and the normal third-class creditors for claims of (re)insurance creditors to the extent such claims are not covered by tied assets (such as *e.g.* reinsurance claims). These (re)insurance claims rank higher than *e.g.* senior debt creditors.

The goal of a restructuring is to overcome the insolvency threat and to avoid the bankruptcy of the (re)insurance company while keeping the focus on the protection of the insureds. This may, but need not, result in the continuation of the original (re)insurance company. The (re)insurance agreements of the insureds may also be continued by transferring them to another (re)insurance or rescue carrier. Another possibility is the run-off of the original (re)insurance company. In the run-off, no new business is written and the existing (re)insurance contracts will be fulfilled. The (re)insurance company will be released from supervision once all (re)insurance agreement will have been fulfilled.

b) *Differentiated Intensity of Supervision (Draft article 30a-article 30d)*

The current ISA is based on the principle that all insureds (*i.e.,* irrespective of whether they are private persons, small or mid-size companies, large corporates or direct insurers) require the same level of protection. The law does not tie the supervisory regime to the level of protection of the respective category of insureds. As of today, the only exception to that rule is that for companies that only conduct reinsurance business, a lighter supervisory regime applies (article 35).

The draft bill changes this approach: insurance companies transacting with professional insureds will benefit from relaxed regulation and reduced supervision. Crucially, primary insurance companies will no longer have to cover their liabilities to professional insureds with tied assets. From an operational point of view, this is a welcomed piece of deregulation. The tied assets rules as currently enforced forbid any manner of comingling with non-tied assets, raising operational costs (separate custody/cash accounts etc). The rationale behind the recalibration of supervisory intensity is that professional insureds should be in a position to fend for themselves, *i.e.* to apply security measures and be able to assess the financial strength of the counterparties from which they buy insurance as well as the details of the insurance agreements themselves.

The precise delineation of the category professional policyholders is one of the most debated elements in the draft bill. It should operate on clear quantitative criteria and align with article 98a of the Insurance Contracts Act (also currently under revision).

c) Other Areas of Deregulation

i. InsurTech Solutions (Draft article 2 (3) and article 11)

Under the current regulatory framework, any business a (re)insurance company wishes to undertake and which resides outside and is not ancillary to the business of (re)insurance is subject to prior approval by FINMA. In deciding whether or not to grant approval, article 11 provides FINMA essentially with unlimited supervisory discretion.

The draft bill establishes a more flexible supervisory regime for innovative insurance solutions. Under the revised article 11, FINMA must grant approval to operate non-insurance related business provided that these activities do not compromise the interests of the insureds. In case FINMA were to dismiss a request by a supervised (re)insurance company, it must provide a reasoned and properly documented decision.

The industry welcomes the proposed liberalisation. However, the Swiss Insurance Association (SIA) voted in its response to the consultation to further relieve innovative (re) insurance solutions from regulatory constraints and thereby strengthen the competitiveness of the Swiss financial market. As a consequence, the SIA suggested to introduce a new supervisory category of "simplified supervision" if certain conditions are fulfilled and to implement a "supervisory free" category for small innovative businesses of up to CHF 1 million business volume which products have limited economic relevance and are offered to a maximum of 1,000 insureds (sandbox model). In addition, the SIA recommended to further relax article 11 and permit (re)insurance companies to offer insurance related as well as insurance supplementary services (to the extent that the risks of the latter do not exceed 10 per cent of the entire target capital of the (re)insurance company).

ii. Tied Assets Rules for Foreign Branches of Swiss Insurers (Draft article 17 (2))

Article 17 (2) obliges a Swiss-domiciled carrier to hold tied assets as cover for foreign insurance liabilities, unless the foreign jurisdiction concerned mandates equivalent asset coverage. This requirement disadvantages Swiss insurance companies which are active on a cross-border basis vis-à-vis foreign competitors operating under less prescriptive insurance regulation.

The draft bill abandons the requirement to hold tied assets for the insurance portfolio abroad if the insurance is offered through a local branch.

iii. Penal Provisions (Draft article 86 and article 87)

The draft bill recalibrates the enforcement model away from penal provisions and the threat of monetary fines to the primacy of supervisory review and enforcement. It retains only those penal provisions that protect crucial elements of the supervisory framework and lowers the maximum level of fines which may be imposed.

The intention is to align the penal provisions in the ISA with the penal provisions in the recently enacted FinSA (articles 89-92) and implement the principle that lawful behavior shall to the extent possible be ensured through regulatory and supervisory instruments.

d) Additional Clarifications

i. Clarification of the Statutory Basis of the SST (Draft article 9, article 9a and article 9b)

The Swiss Solvency Test (SST) is the risk-based solvency regime for Switzerland. The SST is implicitly already covered in the ISA. With the proposed new rules, the SST shall find an explicit and clear legal basis in the ISA which clarifies the powers of the Swiss Federal Council. At the same time, the revised provisions shall replace terminology in the current law which still relates to the old solvency provisions. The revised rules do not aim to change the calibration of the SST. This will need to be addressed in the implementing Insurance Supervision Ordinance (ISO) and/or the FINMA guidance.

The SIA pointed out in its response to the consultation that it supports the revision of article 9, 9a and 9b. It recommended, however, to broaden the wording in article 9a (1) which determines the valuation methods for the risk-bearing and target capital.

According to the recommendation of the SIA, the valuation method for positions in the balance sheet shall be changed from "market values or mark to market values" to "on a market compliant basis". This is particularly relevant for balance sheet positions without an obvious market value which is *e.g.* the case for the insurance technical obligations. The broader wording would be in line with international standards (see Standard ICP 14.5.7. of the International Association of Insurance Supervisors (IAIS)).

The proposed adjustment to article 9a (1) shall ensure adequate capital requirements, and consequently safeguard the competitiveness of the Swiss (re)insurance industry as well as the interests of the insureds. In addition, the SIA suggested to explicitly include in article 9b that the Swiss Federal Council should consider the particularities of the specific insurance activity (such as whether the business is of a short-term or long-term nature) when issuing the implementing ISO provisions.

ii. Supervision of Swiss Branches of Foreign (Re)insurers (Draft article 2 (1) (a) and (b))

The draft bill updates the supervisory regime applicable to foreign (re)insurers' Swiss branches exclusively underwriting business outside of Switzerland.

The proposed article 2 (1) (a) explicitly states that a (re)insurance company with a domicile in Switzerland is in any event subject to FINMA supervision, irrespective of the type of (re)insurance activity it undertakes. With such clarification it becomes obsolete to list the individual primary and reinsurance areas which are subject to supervision on the statutory level. This is in line with current practice.

Foreign insurers which undertake primary insurance activity in or from Switzerland are already today subject to FINMA supervision, unless an international treaty exempts such activity. The key change effected by the draft bill is to also subject reinsurance business underwritten in or from Switzerland to FINMA supervision, to the extent that foreign reinsurers establish a branch office in Switzerland. Recent years have seen an increase in the number of foreign-owned branch offices conducting non-supervised reinsurance business from Switzerland. The draft bill intends to close this gap which has come under increased scrutiny as of late and has given rise to reputational concerns. Existing Swiss branches of foreign reinsurance companies, will benefit from a grace period of six months before the requirement to comply with the supervisory rules becomes effective.

iii. Internal Audit (Draft article 27 (2))

The current article 27 (2) authorises FINMA in specific circumstances to release (re)insurance carriers from the duty to implement an internal audit function. Such exemption option shall be abandoned given that it is no longer in line with today's governance requirements for financial institutions and caused an issue under the European Union's third country equivalence regime.

e) Insurance Broker Regulation (Draft article 42-article 45)

The proposed conduct rules for insurance brokers provide for a level playing field with the conduct rules in the FinSA. The conduct rules should be specifically tailored to the needs of the insureds, *i.e.* not every insurance advice provided by an insurance broker is subject to the same level of conduct rules (see next paragraph f)). The *independent insurance broker* has to disclose the compensation he/she is paid by a third party for providing the services. In addition, an insurance broker must not simultaneously act as dependent and independent insurance broker due to the independent insurance broker's fiduciary duties vis-à-vis the insureds.

The SIA further suggests in its response to the consultation to introduce an education and professional development obligation for insurance brokers as well as a uniform registration duty for all insurance brokers with an independent private registration authority supervised by FINMA. These measures aim to safeguard the quality of the brokerage activities.

f) Specific Life Insurance Regulation (Draft article 37 and articles 39a et seqq)

Analogously to the FinSA, the proposed ISA rules require from the provider of *qualified life insurance products* the drafting of a base information document, specific information duties, a suitability assessment as well as proper documentation. According to the proposed article 39a, life insurance products for which the insured bears an investment risk as well as capitalisation and tontine products are covered by the definition of qualified life insurance products.

The SIA considers such definition, however, as too broad and wants to limit it to unit-linked life insurance and capitalization products without guaranteed performance as well as tontines products in order to align with the scope of the FinSA requirements.

The SIA criticised in the consultation that the pension conversion guarantee premium (*Rentenumwandlungsgarantieprämie*) for the pension fund business should be explicitly included in the ISA. Considering the excessive pension fund conversion rate, life insurance companies need to be in a position to obtain adequate premiums in order to appropriately finance the old age allowances.

3) Implementing Regulation

The revision of the ISA will also need to be further specified in the ISO and potentially other implementing regulations by FINMA. The consultation on the revision of the ISO can only be initiated once the deadline for requesting a referendum on the level of ISA has elapsed without a referendum being requested.

Petra Ginter (petra_ginter@swissre.com)

[1] To the extent the author expresses any view or projection in this article, it is the personal view or projection of the author and does not reflect a policy or position of Swiss Re or the Swiss Insurance Association.

Can publicly available data become insider information?

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Investors of the twenty-first century can harness the power of publicly available data to form a view on a specific company or – more generally – on a particular investment topic. Satellite imagery, marine and air traffic trackers, keyword or search engine trends can provide critical insights on how a company is performing, sometimes unbeknownst to the company itself and most other interested investors. This contribution explores whether there are circumstances in which data extracted from public sources is or can become insider information under Swiss law.

By Ariel Ben Hattar

1) Introduction

At first, the idea that publicly available data, or the aggregation of publicly available data, could become insider information seems like a contradiction in terms. An example can however illustrate potential points of contact between the two. An investor acquires foot traffic data covering streets neighboring a sample of stores of a company. By monitoring the data at regular intervals and correlating it with financial results of the operator of the stores, the investor can form a view on how the company is doing during a particular quarter earlier than when the company releases its quarterly updates. It may even be that the company only receives information about its performance at a later date, when it receives data from its stores through its internal accounting and monitoring processes, not to mention investors who have not invested the kind of efforts and money necessary to acquire the foot traffic data.

As the above example shows, through technology and financial capacity, some investors may gain an edge over their peers by acquiring and processing vast quantities of data that is publicly available. Other investors could acquire the same data sets, which cover foot traffic in public spaces, or they could commission third parties to assess foot traffic around the stores by simply walking around them and counting the number of people walking by the stores. The costs of such an exercise would, presumably, be very significant, so much so that a majority of investors will never be able to afford them. While it can generate a sense that a level playing field between investors is lacking, does this use of publicly available data amount to insider trading? To answer this question, it is first necessary to take a step back and consider the current state of insider regulation in Switzerland.

2) From "Who" to "What"

When Switzerland first criminalized insider trading in 1987, the assumption was that insider information necessarily came from within the company. At the root of insider trading lied a breach of trust. A company had entrusted a director, employee or advisor with a confidential information and the information's recipient breached the company's trust by misusing the information, either to trade based on it or to communicate it to a third party.

This view did not survive the revision of the rules on insider trading that entered into force in 2013. The revision created a new category of insiders: those who do not access insider information due to their privileged ties to the company. A commonly used illustration of this new category is that of a contractor cleaning corporate offices who finds a document containing insider information in a waste bin. This example is however somewhat misleading, as the confidential information still comes from within the company. A more illustrative example would be the case of a fund manager who learns that another investor is about to launch a public takeover offer for the company. In such a situation, the company may not even be aware of the insider information, as it comes from a decision of a third party investor.

As a result of these changes, delimitating the scope of the insider trading prohibition is now less about *who* the insider is vis-à-vis the company, but rather about *what* constitutes insider information. When looking at a particular piece of information, one must therefore determine if it fits into the definition of insider trading of article 2 (j) of the Financial Market Infrastructure Act (FMIA).

3) The Spectrum of Publicly Available Data

Before examining the components of the definition of insider information in more details, it is helpful to establish first that publicly available data can take several forms, not all of which present the same challenges for the analysis presented herein. To simplify, I have divided publicly available data into the following three categories.

- **Published data:**

  In its most basic form, publicly available data encompasses information that has been made available to all interested persons through actions designated to achieve such purpose, *e.g.* through a press release of the company or an article published in a newspaper. I refer to this type of information as "published data".

- **Data from public sources:**

  A second category of publicly available data is information that can be found in or deduced from public sources, even though it is not published data. A public source, in this context, is a source of information that anyone could access (even if against a fee, upon request or by taking specific actions, *e.g.* being in a certain place). This category includes, for example, observing from a passing train that the main factory of a company is in flames (on this example, see Section 4.c)iii) below), examining public records available upon request (*e.g.* archives), or attending industry conferences.

- **Aggregation of data from public sources:**

  Finally, publicly available data includes the aggregation of data from public sources. Examples include data derived from pictures of multiple locations taken by satellites, exit polls conducted during elections or aggregations of online reviews of a restaurant chain.

4) Publicly Available Data and Insider Information

a) Article 2 (j) FMIA

Pursuant to article 2 (j) FMIA, an insider information is (i) an information that (ii) is confidential and (iii) is susceptible, if disclosed, of having a notable influence on the price of securities admitted to a Swiss trading venue (*i.e.* a Swiss stock exchange or multilateral trading facility). The relevance of publicly available data for each of these criteria is examined in the following sub-sections.

b) Is Data Information?

To be relevant in the context of the Swiss insider rules, publicly available data must first be tangible enough to qualify as an "information". An information is generally about a fact, and not merely about a rumor or a speculation.

There is nothing inherently non-factual about publicly available data. If anything, publicly available data will generally tend to be fact, although this will evidently depend on the source of the relevant data. Recommendations based on, or conclusions drawn from, publicly available data may however fall short of being facts. Deducing from car traffic data around stores that a supermarket chain is having a good or bad quarter could for example amount to only a speculation if the supermarket chain also derives significant turnaround from its online activities.

c) Confidentiality and Publicly Available Data

i. The different approaches to confidentiality

Although it is mentioned in article 2 (j) FMIA, confidentiality is not further defined in the context of insider trading regulation. Precedents from the Swiss Supreme Court indicate that information is not confidential when it is almost certainly known by an extended circle of market participants (decision published in BGE 118 Ib 448, consideration 6b/aa) or when it can be discovered by third parties, even if this requires efforts (Supreme Court decision 2A.230/1999, consideration 6b). Some scholars have taken a different view and argue that information is confidential unless it is widely available through generally accessible means. As will further be explained below, to what extent publicly available data could be considered as confidential depends on which one of these views is upheld.

To account for the centrality of confidentiality to assess the status of publicly available data under insider trading regulation, I analyze it from the perspective of all three categories of publicly available data described under Section 3.

ii. Published data

Data that has been made available to the public through actions intended to achieve this purpose are, by essence, not confidential (anymore). This is the case even if the relevant information does not appear on a widely read newspaper, is not displayed prominently on the company's website or does not appear in an "ad hoc" publicity press release published under the listing rules of SIX Swiss Exchange or in a similar document. It should indeed not be that investors have to ask themselves whether a document found *e.g.* on the Internet is sufficiently well advertised to be considered as not confidential anymore. The conclusion that published data is not confidential should hold true reached regardless of which of the interpretations of "confidentiality" referred to above is followed.

iii. Data from public sources

For what regards data gathered from public sources, the different approaches to confidentiality lead to different outcomes.

If the theory according to which information is confidential if it is not available through generally accessible means were to prevail, then information obtained from public sources could sometimes be deemed confidential. For example, a scientific paper demonstrating that a particular molecule is ineffective to cure a medical condition may only be accessible to the subscribers of the journal in which it is published. Those subscribers would then not be allowed to use this information to trade the shares of a company that wishes to use the molecule, since there is probably only a fraction of all interested investors who subscribe to the journal. To regain their ability to trade the relevant shares, those who have access to the scientific article would need to either wait for a newspaper to cover the story or for the company to publish an "ad hoc" press release, or even engineer a publication of the paper's findings on their own (which would raise a host of different challenges). Such a conclusion would evidently be problematic and cannot, in my view, be supported.

Following the reasoning of the Supreme Court, however, leads to a coherent and – in my view – correct solution. From the Supreme Court's perspective, what matters ultimately is whether other investors *could* access the relevant information, even if it costs them money or efforts. In the above example, all investors could access the information contained in the scientific paper by subscribing to the journal, although they would need to pay a (potentially not insignificant) fee to do so. The fact that specialized knowledge may be required to understand the ramifications of the paper is also not relevant. Although an issuer itself may be expected to explain its business activities in layman's terms when communicating with its shareholders, investors who have a better grasp of those activities (or who can commission third party to do the analysis for them) should not be restrained in their ability to trade by their superior knowledge. While it is true that retail investors would be unlikely to invest the kind of efforts and money needed to achieve this, the purpose of insider trading regulation is not to ensure that all investors have the same actual knowledge, which would anyway be impossible. Rather, it is to ensure that trading is based on information that all investors could access.

A similar conclusion would be reached in the European Union under Regulation (EU) No 596/2014 of the European Parliament and of the Council of April 16, 2014 on market abuse (MAR). In its guidance on MAR, the United Kingdom's Financial Conduct Authority (FCA) relates the following example: a passenger on a train passes a burning factory and calls his broker, asking the latter to sell all his shares in the factory's owner. As the investor obtained the information that the factory's owner may be in trouble by legitimate means through observation of a public event, the FCA concludes that, under MAR, the passenger is not considered to have used insider information.

On one aspect, the FCA's view and Swiss law may differ. The FCA notes that the information must have been obtained through legitimate means by the investor. From a Swiss law perspective, the key requirement is that third parties should be able to obtain the same information. In my view, an investor who broke the law to access information will only possess insider information if other investors cannot access the same information without also breaking the law. To put it differently, if there is a legitimate way to obtain the information, it should not be considered as confidential.

iv. Aggregation of data from public sources

From a theoretical perspective, aggregating data from the public sources is no different than making individual observations based on those sources. The same conclusions (described under section iii)4.c)iii) above) should therefore apply.

Aggregating multiple data sources may however require efforts so significant that most investors, even professional ones, will not have the resources to replicate the data aggregation effort. In addition, contrary to single use of public sources, an investor cannot hope to simply be lucky, *e.g.* being in the vicinity of a factory when it is engulfed in flames, or by having expert knowledge in the company's business. Furthermore, aggregating multiple sources of data may allow one to form a view on a matter affecting a company long before the company itself becomes aware of it. The same is generally not true with respect to one-time events like the publication of a scientific paper or a burning factory, where the time gap between the moment the first investor becomes aware of their occurrence and the moment the company announces them will tend to be short.

The particularities of the aggregation of publicly available data are nonetheless not such that they justify a departure from the Supreme Court's theory. Those specificities however call for a closer examination of the relevant facts, and particular attention should be paid to the possibility for third party investors to replicate the data aggregation. In this respect, the following should be considered.

– The requirement set forth by the Supreme Court is that third parties should be able to gain access to the information. There is no implication that the access should be on the same terms, or that it should involve the use of the same technical means. As a practical matter, investors conducting data aggregation analyses should be wary of agreements giving them exclusive access to data sources. By the same token, investors creating their own tools to find and aggregate publicly available data may prefer to make these tools available to third parties (against a fee). It will indeed be easier to demonstrate that information is not confidential if third parties could have used the same source, as opposed to proving that other sources would have been available.

– There is no explicit or implicit threshold for the costs beyond which investors would be presumed not to have the ability to replicate a data aggregation. The fact that most investors would not be able to bear the costs of an analysis is not, in and of itself, conclusive to hold that the result of the data aggregation is confidential information.

The use of aggregated data to produce financial research can also raise questions, which are addressed in more details under Section 5 below.

d) Price-Sensitiveness

Finally, article 2 (j) FMIA provides that an information is considered as insider information if it is price-sensitive, *i.e.* if its disclosure would be susceptible of having a notable influence on the price of securities in scope of the Swiss insider trading rules. To me, there are two possible ways to address this element.

– The first is to consider that if an information is based on data that is publicly available, then the whole question is moot. It would indeed not be necessary to ask how the market will react if the information is disclosed because by nature it has already been disclosed. In my view, this approach is artificial. The price-sensitiveness of an information is linked to the process through which the market at large reacts to and prices in the information as it becomes aware of it. The fact that an information is publicly available does not mean that it has already been processed and priced in by the market, and is thus not susceptible to have a notable influence on the price of securities anymore. On the contrary, as we have seen, there may be a significant time gap between the moment one investor has processed publicly available data and the moment the company and the wider market become aware of it. In that sense, the "disclosure" to which article 2 (j) FMIA alludes is different from the concept of "confidentiality". An information can thus remain undisclosed although it is not confidential anymore.

– The second, which I hold to be the correct approach, is to consider that publicly available data is also susceptible of being price-sensitive. In most cases, however, there will be no need to answer the question of the price-sensitiveness of publicly available data. If the information is not confidential (and publicly available data should generally not be confidential), then it is not insider information and its possible influence on the price of securities is irrelevant.

5) Research Products Based on Publicly Available Information

a) The Mosaic Theory

One area where the use of publicly available information has been discussed in a Swiss insider trading regulation context is that of financial research, and in particular the "mosaic theory". Originally a U.S. legal construct, the mosaic theory posits that the use in financial research of a mix of publicly available and not publicly available (but not individually price-sensitive) information is permissible and that the result of the analysis of such information should not be considered as price-sensitive.

In its report on the consultation on FINMA Circular 2013/8 – "Market conduct", FINMA noted that "in the normal case" Swiss law does not contradict the mosaic theory. FINMA's view is to be approved. On the one hand, publicly available information should generally not be confidential and, hence, not qualify as insider information. On the other hand, confidential information that is not price-sensitive is not insider information either. Combining both should therefore not create insider information. To us, this is the case even if an analyst does more than just aggregating data but adds a layer of personal opinion or an intellectual reasoning to the analysis.

b) When Does a Research Product Become Insider Information?

In connection with the mosaic theory, also FINMA noted that the publication of a research analysis may itself be insider information, even if the analysis does not contain insider information. FINMA gave very limited guidance on when exactly it considers that this is the case, and a few additional explanations are in order.

i. The analysis versus its publication

An analysis not based on insider information cannot *per se* become insider information. As FINMA notes, it is the analysis' *publication* that can be relevant in an insider trading regulation context. Analyses based on publicly available (and potentially also on confidential but not price-sensitive information) that are not published are thus never insider information. Those can be freely communicated to the investor who commissioned the research, for example, or be used to trade by the entity that produced them.

Treating the publication of an analysis as insider information *inter alia* means that the analysis should not be communicated selectively to third parties in advance of its release. Still, it does not mean that the only way to avoid committing a breach of insider trading rules is to make the analysis freely available to all investors (*i.e.* to make it published data, to use the terminology described under section 3). Rendering the analysis *available* to interested investors, even if they are required to pay a fee to access it (*i.e.* making it publicly available), is sufficient.

ii. Determining when the publication of an analysis is insider information

Far from all publications of analyses based on publicly available data should in practice be insider information. To identify those that may qualify as such, one may point to the author of the analysis as a key criterion: the word of a famous hedge fund manager or large bank is known to weight more than that of a retail investor. The identity of the person authoring or publishing the analysis is however only one part of the equation. An analyst famous for his coverage of company A should not be restricted in the way she talks about company B, an issuer she does not usually cover. Similarly, large banks produce copious amounts of research, some of which contributes only to a limited extent to the price formation process.

In line with the solution found in the European Union, the decisive factors to assess whether the publication of a research product is insider information lies in the market's expectations. Specifically, according to recital 28 to MAR the publication of an analysis can become insider information in two situations:

– if the analysis contains the views of a recognized market commentator or institution which may inform the prices of related financial instruments; or

– if the analysis is routinely expected by the market (*e.g.* because it is published every quarter) and known to contribute to the price formation process of financial instruments.

These two cases are closely linked. To me, it would be incorrect to treat the publication of any view of a known commentator or prestigious financial institution as insider information. What recital 28 to MAR means is that, if a commentator or financial institution produce a kind of analyses that regularly trigger notable price movements, the publication of *analyses of the same kind* should be considered as insider information.

For example, if an analyst authors publishes monthly research notes on pharmaceutical companies that are known to trigger sharp increases in the price of those companies' shares, then future iterations of those notes may need to be treated as insider information. If the same analyst produces a separate research note on a car company, then the publication of this latter analysis is not insider information because it is an analysis of a different kind, for which the market has no or different expectations. Similarly, the research coverage of an issuer by a large investment bank may be closely followed by the market, to the point where updates by the investment bank trigger significant price movements in the shares of the issuer. Although those updates will be treated as insider information, research material published by the same bank regarding other issuers will not be contaminated and will not automatically be considered as insider information.

iii. Impact beyond financial research

Interestingly, the ramifications of recital 28 to MAR extend beyond financial research *stricto sensu* and, in particular, also affect benchmarks. For example, some "rig counts" (*i.e.* recensions of the number of active oil or gas rigs) are based on publicly available data and are known to move the share price of companies active in the oil and gas drilling sectors. Although their content is based on publicly available data that is not insider information, the publication of these benchmarks should be treated as insider information because the market has come to expect them and they are known to have a notable impact on the price of certain securities.

6) Conclusion

Since the revision of the Swiss rules on insider trading which entered into force in 2013, insider information does not need to come from "inside" the company to which the information relates anymore. Depending on how the concept of confidentiality is interpreted, large swaths of publicly available data could be considered confidential, and potentially insider information. According to the view described in this contribution, publicly available data should however generally not be considered as confidential, and should consequently not qualify as insider information.

Investors willing to use technology to analyze publicly available data on a large scale should however be mindful that a possible characterization as insider information largely depends on the replicability of their analysis by other investors. For this reason, it may be advisable to avoid contracting third party service providers (*e.g.* satellite imagery services) on an exclusive basis. Data suppliers, producers of benchmarks and analysts should also consider that the publication of their products can become insider information, even if these products are based on publicly available data and are not themselves insider information.

Ariel Ben Hattar (ariel.benhattar@lenzstaehelin.com)

Popular Initiative on Responsible Enterprises: Switzerland's Long Arm on Subject Enterprises

Reference: CapLaw-2019-14

Although its fate and timing are very unclear, the popular initiative "for responsible enterprises – for the protection of human rights and environment" (initiative on responsible enterprises; *Konzernverantwortungsinitiative*; *Initiative Multinationales Responsables*; "Initiative") is not only hotly debated among the many Swiss based international companies that would be affected by it, but also among lawmakers in Berne. In short, the Initiative, which is expected to be voted upon by the Swiss people, proposes that enterprises shall be held liable before a Swiss court if one of its controlled enterprises violates human rights or environmental standards abroad. These enterprises will have additional duties and will have to monitor and report on the compliance with these duties.

The Initiative raises a bundle of legal questions of which we focused on one: Its scope of applicability. As we will see, a far reaching concept is proposed to ensure that a large number of enterprises is subject to the Initiative.

By Thomas U. Reutter / Annette Weber

1) "Enterprises"

The Initiative is applicable to enterprises (*Unternehmen*) having their registered office, central administration (*Hauptverwaltung*) or principal place of business (*Hauptniederlassung*) in Switzerland ("subject enterprises"). The term "enterprise" shall ensure that all kinds of undertakings are captured, irrespectively of their legal form.

Although not stated in the proposal, the explanatory notes of the sponsors (the "Explanation") add that only private enterprises (*privat tätige Unternehmen*) fall under the scope of applicability. Hence, it seems that the intention is to exempt any enterprises which fulfil sovereign tasks. Enterprises controlled by a government are therefore not exempted if they act as private players.

2) Registered Office/Central Administration/Principal Place of Business in Switzerland

The Initiative provides an interesting mix of economic and legal concepts to ensure that not only businesses incorporated in Switzerland but also those managed out of Switzerland are captured: An enterprise must have either (i) its registered office, (ii) central administration (*Hauptverwaltung*) or (iii) principal place of business (*Hauptniederlassung*) in Switzerland. The registered office of an enterprise is the seat set out in the articles of incorporation. "Central administration" refers to the place at which the decision making or the management of an enterprise is made. The main activities (for example the main production of an enterprise's goods) define the principal place of an enterprise. The three places are meant to apply alternatively, *i.e.*, it is sufficient if one of them is met. The concept was taken from the Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters. The sponsors thus follow the concept of an international treaty applicable to European countries rather than Swiss international private law in order to provide a maximum of fora legally possible.

3) Business Abroad

The Initiative limits its application indirectly by imposing duties which subject enterprises and their controlled enterprises (see below for a definition of "controlled enterprises") shall fulfil *abroad*. Enterprises (or their controlled enterprises) which do not have a business outside of Switzerland obviously do not have to adhere to the duties and are not subject to the liability regime set out in the Initiative.

The Initiative does not limit the application to specific foreign jurisdictions, for example, to jurisdictions which do not have similar human rights or environmental standards as Switzerland. As a result, enterprises with businesses, for example, in Germany, will be subject to the duties and the liability regime in principle, although in practice, the focus will be on enterprises with businesses in countries lacking a fully developed judicial system and rule of law.

4) Controlled Enterprises

Subject enterprises do not only have to ensure that they themselves comply with the duties set out in the Initiative but also the enterprises they control. The Initiative does not provide a definition of "control". Instead it states that the actual circumstances are decisive and that control may also be exercised by using economic power.

The term "control" as proposed by the Initiative appears to go beyond the usual concepts used in financial reporting and to again combine the relevant legal and economic concepts – to extend its reach or to avoid abuses – depending on the point of view. "Controlled enterprises" include therefore subsidiaries but may also extend to companies that are not consolidated into the relevant group of companies in case there is factual control over such outside enterprises. For example, a supplier which delivers exclusively to and is accordingly fully dependent on a subject enterprise (or one of its controlled subsidiaries) may be regarded as a "controlled enterprise".

However, a different reading of "factual control" may also lead to a narrower interpretation: The mere majority ownership of shares in a company, even though trigging financial consolidation requirements under most accounting standards, does not mean factual control. Accounting standards typically require the *ability* to exercise control by holding a majority stake in a company whereas the *actual* exercise of control is required for factual control which is a higher standard. For example, a passive majority shareholder – in the extreme a financial investor who is not represented on the board of its subsidiary which runs local operations by local management independently – will hardly have factual control. "Factual control", *i.e.* some form of subordination expressed by the power to give binding instructions, is also required for the concept of liability of a principal vis-à-vis its agent (*Geschäftsherrenhaftung*) which provides the model for liability under the Initiative. Although hardly intended by the sponsors, one may not exclude that the concept of "factual control" may in certain cases lead to a scope of companies narrower than under most relevant financial reporting standards. In practice, the exercise of (factual) control (vs. the mere ability to exercise control) will be difficult to assess without further guidance in the transposing statute.

In the context of a group of companies, the Initiative does not require that the subject enterprise is the ultimate holding company of a group of companies. It therefore targets subsidiaries as well. International operating groups of companies will therefore have to carefully analyze whether one of its group companies fall under the scope of the Initiative.

5) SME

The Initiative does not provide for an exemption for international operating small and medium sized companies (SME). SME are only addressed in the sub-provision dealing with duties of diligence: "The lawmaker shall consider the needs of SME with low risks" implying that such SME shall have less extensive duties. The Explanation is somewhat misleading in the absence of a specific exemption for SME as such in stating that "SME are basically exempt from the Initiative unless they are active in a business of a high-risk sector". In substance, however, it seems rather obvious that SME shall not be subject to the same standard as multinational corporations. In case the Initiative is adopted, the legislator will have the discretion (but no duty) to include such an exemption in the statute transposing the Initiative because the duties and the liability set out in the Initiative are principle based.

6) Conclusion

The Initiative chooses a novel approach for its scope of application. Broad in concept, it limits its applicability in certain instances. The Initiative will impose also duties on foreign enterprises with a central administration or principal place in Switzerland and allow liability claims against such enterprises in Swiss courts although the relation to Switzerland will be remote in such cases. Multinational groups of companies may become subject to the Initiative by surprise as a result of the Initiative's extensive scope.

If the Initiative will be adopted, subject enterprises may try to either (i) minimize their business in Switzerland in a way that they will not be subject to the Initiative, (ii) exercise less control on subsidiaries or enterprises more generally, e.g. by outsourcing certain businesses to third parties, in order to avoid "factual control", or (iii) take more control over their subsidiaries and independent contractors in order to ensure compliance with the duties and to minimize liability exposure under the Initiative. The outcomes described in (i) and (ii) are hardly in the interest of corporate social responsibility while the outcome described in (iii) may not be in the interest of the foreign local enterprise and the local market at large. In any event, the Initiative, if adopted, will likely change the way business is done by international groups with substantial Swiss presence – potentially also in ways which were not intended by its sponsors.

Thomas Reutter (thomas.reutter@baerkarrer.ch)
Annette Weber (annette.weber@baerkarrer.ch)

Digital Assets – Proposed Amendments to the Legal and Regulatory Framework of Distributed Ledger Technology in Switzerland

Reference: CapLaw-2019-15

Switzerland targets adjustments of the existing legal and regulatory framework of distributed ledger technology (DLT). The Federal Council initiated consultation on proposed amendments to, *inter alia*, civil law (including securities law), insolvency law, financial market law, and anti-money laundering regulation on 22 March 2019. This article summarizes the key points of the suggested adjustments and analyses their potential impact on market participants. The content of the rules may still be subject to changes in the ongoing legislative process.

By Luca Bianchi / Fabio Andreotti

1) Introduction

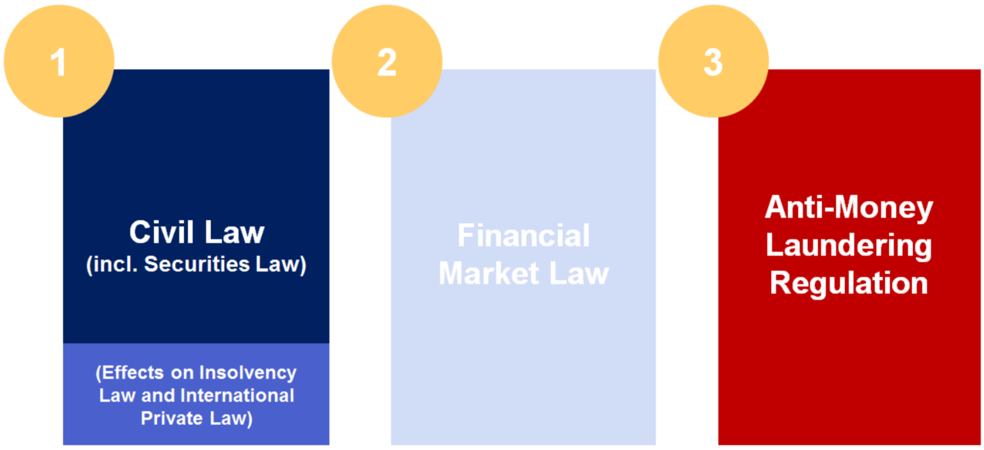
In recent years, the blockchain and initial coin offering (ICO) industry has been subject to a very strong growth in Switzerland as well as globally (CapLaw-2016-47, 25 et seq.). As a consequence, regulators and legislators worldwide are in the process of solving two fundamental problems, namely: the ***regulatory mismatch*** between historically grown and, thus, outdated laws and innovative business models (***Problem 1***); and the ***lack of legal certainty*** for market participants caused thereby (***Problem 2***) (CapLaw-2017-02, 14; CapLaw-2016-31, 4). Solving these two problems increases the attractiveness of a country for the digital assets industry in a competitive international environment.

In this context, Switzerland has developed a pragmatic solution which suggests selective amendments to its existing laws. In particular, the Federal Council published a *Report on the Legal Framework for Distributed Ledger Technology and Blockchain in Switzerland* on 14 December 2018 (the ***Report***). Subsequently, the Federal Council proposed related adjustments of the legal and regulatory framework for digital assets based on an *Explanatory Report to the Consultation Preliminary Draft* (the ***Explanatory Report***) of the *Preliminary Draft Federal Law on the Adaptation of Federal Laws to Developments in Distributed Ledger Technology (DLT)* (the ***Preliminary Draft*** or ***PD***) of 22 March 2019.

An overview, the key points of the new rules, as well as their impact on market participants in Switzerland are briefly set out in this article. It is completed with a conclusion and an outlook.

2) Overview of the Proposed Amendments

The ***Swiss approach*** to digital assets legislation does not suggest a specific sector regulation or a blockchain law. Rather, ***targeted adjustments of existing laws and regulations*** have been proposed in the following areas:



The chart above shows the main legal areas (***civil law, financial market law, anti-money laundering regulation***) that will be subject to adjustments.

However, further (related) legal fields will be affected by the new legal and regulatory framework for digital assets. In particular, the intended approach in civil law triggers important related adjustments of ***insolvency law*** and ***international private law***.

Thus, the key points discussed below relate to all the legal fields set out above.

3) Key Points of the New Rules

a) Civil Law

The proposed adjustments of civil law (including securities law) comprise the following key points:

- ***Data ownership***: The Report and the Explanatory Report discuss the topic of data ownership, but do not propose the introduction of a general data ownership. Instead, selected changes to the treatment of digital data under specific laws are suggested (*e.g.*, in the area of insolvency law; see Section 3.b.).

- ***Classification of tokens by content***: FINMA has published its *ICO Guidelines for Enquiries regarding the Regulatory Framework for Initial Coin Offerings (ICOs)* on 16 February 2018. In this context, FINMA introduced a classification of tokens in the categories of payment, utility, and asset tokens (as well as hybrid tokens). The Report and the Explanatory Report refer to this classification by content as a meaningful tool under supervisory law.

- ***Classification of tokens by wrapper***: The Report and the Explanatory Report distinguish securities (*Wertpapiere*), uncertificated securities (*Wertrechte*) and intermediated securities (*Bucheffekten*). The legal qualification of tokens according to these categories is frequently unclear under current law. Thus, the introduction of amendments to securities law has been suggested (see next point).

- ***DLT uncertificated securities***: An innovative category of a legal wrapper for tokens shall be introduced: ***DLT uncertificated securities with securities character*** (***DLT uncertificated securities***; *DLT-Wertrechte*) (article 973d PD-CO). DLT uncertificated securities aim to ensure the effective and valid transfer of rights, proof of entitlement, and protection of *bona fide* transactions via a DLT register. The issue of rights as DLT uncertificated securities must be based on a ***registration agreement*** between the issuer and all other parties involved.

- ***Transfer of tokens***: The legal requirements for the valid transfer of tokens are controversially discussed under current law. In order to increase legal certainty, ownership of DLT uncertificated securities shall be ***legally transferable by adjusting the DLT register*** (article 973d PD-CO et seq.), *i.e.*, without the requirement of a written form for the assignment of a claim according to article 165 (1) CO.

- ***Tokenization***: Structuring of rights as DLT uncertificated securities shall be possible for ***all rights which have been suitable for securitization in the form of negotiable securities*** in the past. In particular, DLT uncertificated securities shall enable companies to tokenize their ***shares*** (*Aktien*) – which must be provided for in the articles of association (cf. article 622 (1) PD-CO) – or ***bonds*** (*Anleihen*) (article 973d PD-CO). Furthermore, ***contractual obligations*** (*vertragliche Ansprüche*) are mentioned as suitable for tokenization by the Explanatory Report, 29. This most notably includes ***claims*** (*Forderungen*). However, the tokenization of ***certain other assets*** (*e.g.*, ownership of movable or immovable property) may be subject to ***challenging legal questions, restrictions and limitations*** (Report, 52 et seq. and 64 et seq.; Explanatory Report, 29) which should be considered before launching a new token.

b) Insolvency Law

Following the approach chosen in the area of civil law, the following adjustments have been suggested for insolvency law:

- ***Segregation of digital assets in bankruptcies***: Effective segregation of tokens in the event of bankruptcy of a wallet provider is currently subject to legal uncertainties for the holder of such digital assets. Thus, the Federal Council has proposed a new provision stipulating a respective segregation right (article 242a PD-DEBA). This new provision shall, upon request of the beneficial owner, allow for the ***segregation of crypto-based means of payment and DLT uncertificated securities***, provided that the bankrupt wallet provider has the power of disposal over the assets on behalf of the beneficial owner and the assets can be assigned to the beneficial owner by way of the DLT register at any time. If assignment of the tokens to the beneficial owner is not possible, the tokens form part of the bankruptcy assets of the wallet provider.

- ***Access to data***: Furthermore, the Preliminary Draft stipulates a right of access to data stored with the bankrupt wallet provider (article 242b PD-DEBA). Such right may be relevant in cases where the customer wishes to transfer tokens out of a multi-signature wallet and, while the wallet provider ***does not have the power of disposal*** over the tokens – as compared to the cases pursuant to article 242a PD-DEBA –, the wallet provider does have ***effective access*** to the required private key(s).

- ***Special provision for banks***: In the case of a bank acting as a custodian, crypto-based assets deposited with such bank shall be subject to separation *ex officio* pursuant to article 37d PD-BA (article 16 (1^{bis}) PD-BA).

c) International Private Law

Against the background of the proposed changes in civil law, a few related changes to international private law have been suggested:

- ***Applicable law for securitization and the transfer of claims***: A draft provision in the PD-PILA is concerned with the applicable law for the securitization and the transfer of claims, including DLT uncertificated securities (article 145a PD-PILA).

- ***Applicable law for pledging of claims and other rights***: Furthermore, a provision regarding the applicable law for the pledging of claims and other rights which are securitized, including DLT uncertificated securities, shall be included (article 105 (2) PD-PILA).

d) Financial Market Law

The following key points are proposed by the Federal Council in the area of financial market law, respectively, financial market regulation:

- ***New license for DLT trading facilities***: A new regulatory category of a centralized financial market infrastructure, the DLT trading facility, shall be introduced in the FMIA (article 73a PD-FMIA). The license to operate a DLT trading facility shall allow for the ***non-discretionary, multilateral trading, settlement and clearing of DLT uncertificated securities and further DLT-based assets*** such as payment tokens (*e.g.*, Bitcoins) and utility tokens as well as the ***central custody*** of these digital assets. This new type of regulatory license should facilitate a variety of new business models.

- ***Organized Trading Facility (OTF)***: An establishment for the discretionary multilateral trading or bilateral trading of tokens that qualify as securities (*Effekten*) is considered an OTF within the meaning of the FMIA under current law (Report, 107; Explanatory Report, 47). Operators currently require a license as a bank, securities firm or trading venue (or recognition as a foreign trading venue). This is problematic according to the Federal Council because operators of such an establishment may not be able to obtain such a license without actually conducting the activities of a bank, securities firm or trading venue. To resolve this problem, persons seeking to operate an OTF ***for the sole purpose of the proprietary trading of tokens that qualify as securities*** (*e.g.*, asset tokens) shall be allowed to obtain a license as a securities firm under future regulation (article 41 (b) (3) PD-FinIA).

e) Anti-Money Laundering Regulation

The following key points have been proposed in the area of AML regulation:

- ***Financial intermediation***: DLT trading facilities shall be classified as financial intermediaries in terms of the AMLA and be obliged to comply with all due diligence obligations of the AMLA (article 2 (2) (d^{quater}) PD-AMLA). In addition, DLT trading facilities shall be subject to AML supervision by FINMA (article 12 (a) PD-AMLA).

- ***Payment tokens and decentralized trading platforms***: Changes to the AMLO are expected to explicitly consider (i) payment tokens that are issued in an ICO and (ii) decentralized trading platforms (provided that the underlying smart contract has power of disposal over third-party assets).

4) Impact on Market Participants

a) Opportunities

In a nutshell, the new legal and regulatory framework would allow for the following important (business) opportunities for market participants:

- ***Opportunity 1***: issuance of ***DLT uncertificated securities***;
- ***Opportunity 2***: obtaining the ***regulatory status of a DLT trading facility***.

b) Threats

Market participants may be subject to the following threats under the new – but also existing – legal framework for digital assets:

- ***Threat 1***: ***regulation*** in Switzerland (or, in case of cross-border activities, in other jurisdictions);
- ***Threat 2***: certain ***licensing*** (and/or ***prospectus [registration]***) ***duties***;
- ***Threat 3***: potentially ***invalid transfers*** of tokens (if legal requirements are not fulfilled);
- ***Threat 4***: failure to comply with ***AML regulation*** (where applicable);
- ***Threat 5***: regulatory and/or criminal sanctions in case of ***a breach of financial market laws*** in Switzerland (or abroad);
- ***Threat 6***: ***liability*** due to breaches of financial market law or civil law.

Regulatory threats for market participants are nothing out of the ordinary. However, overall awareness for such regulatory limitations has notably increased in the market in the last years. Thus, it should be clear by now that the entrepreneurial slogan *move fast and break things* may often be ill-suited for the regulated financial services and products industry if the above stated threats are not taken into consideration.

5) Conclusion and Outlook

The proposed amendments of the legal and regulatory framework for digital assets represent a prudent response of the legislator to the recent developments in the digital assets space. Certain aspects of the intended new rules can still be adjusted to the needs of the digital assets industry. It will be interesting to see whether and to what extent the suggested changes will receive criticism by market participants in the ongoing consultation which ends on 28 June 2019.

From today's perspective, the implementation of DLT uncertificated securities as well as the planned DLT trading facility license can be highlighted as very promising Swiss legal innovations. While Problems 1 and 2 as set out in the introduction above should overall be reduced by the planned amendments, issuers and service providers of digital assets must bear in mind possible adverse consequences due to a breach of regulatory or other legal provisions.

In this context, the upcoming entry into force of the new Financial Services Act (FinSA) and Financial Institutions Act (FinIA) in 2020 should be highlighted. The new laws and their implementing ordinances will likely impose additional legal burdens on the digital assets industry.

Luca Bianchi (luca.bianchi@nkf.ch)
Fabio Andreotti (fabio.andreotti@nkf.ch)

Reporting of Beneficial Ownership in Unlisted Companies according to Article 697*j* CO – Some Open Points

Reference: CapLaw-2019-16

On July 1, 2015, new rules regarding reporting of beneficial owners of unlisted companies entered into force in Switzerland (for general remarks on the rules see CapLaw-2015-55). Even four years after their implementation, there are still a number of open questions in practice as regards the application of these rules, both from the perspective of the shareholders (subject to the obligation to report their beneficial owners(s)) and the companies (subject to the obligation to maintain a register of beneficial owners). One reason for these uncertainties is that the relevant provisions are incomplete and in many aspects leave room for interpretation. To date there is no case law that could provide guidance. A currently ongoing revision of the disclosure rules could bring some clarity.

By Alexander Wille / Lukas Held

1) Legal Basis

According to article 697*j* (1) Code of Obligations (CO), any person who alone or in concert with third parties acquires shares in a company whose shares are not listed on a stock exchange, and thus reaches or exceeds the threshold of 25% of the share capital or voting rights, must within one month give notice to the company of the name and the address of the natural person for whom it is ultimately acting (the beneficial owner). The notification obligation applies to the acquisition of bearer shares (*Inhaberaktien*) and registered shares (*Namenaktien*). Non-compliance with this provision has severe consequences: The membership rights (in particular voting rights) are suspended for as long as the shareholder has not made the required notification (article 697*m* (1) CO). Financial rights (in particular right to receive dividends) may only be exercised once disclosure has been made and are forfeited for the period until disclosure is made (article 697*m* (2) and (3) CO). Companies must keep a register of the beneficial owners reported by shareholders to the company (article 697*l* CO).

The Act on the Implementation of the Recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum Act) is currently being discussed in the Swiss Parliament. The Global Forum Act also provides for amendments of the provisions on disclosure of beneficial owners. The intention behind the proposed amendments is to eliminate some of the ambiguities raised during the consultation process regarding the application and interpretation of article 697*j* CO. It is envisaged that the Global Forum Act will come into force on October 1, 2019.

The obligation of shareholders to report their beneficial owner(s) and the obligation of companies to maintain a register of beneficial owners are equally applicable to companies limited by shares (*Aktiengesellschaften; AG*) and to limited liability companies (*Gesellschaften mit beschränkter Haftung, GmbH*). For the sake of simplicity, in this article reference is solely made to the provisions applicable to companies limited by shares.

This article focuses on some selected practical cases as to which the application of article 697*j* CO has raised questions. For a general overview reference is made to the legal literature on the topic.

2) Private Equity Funds

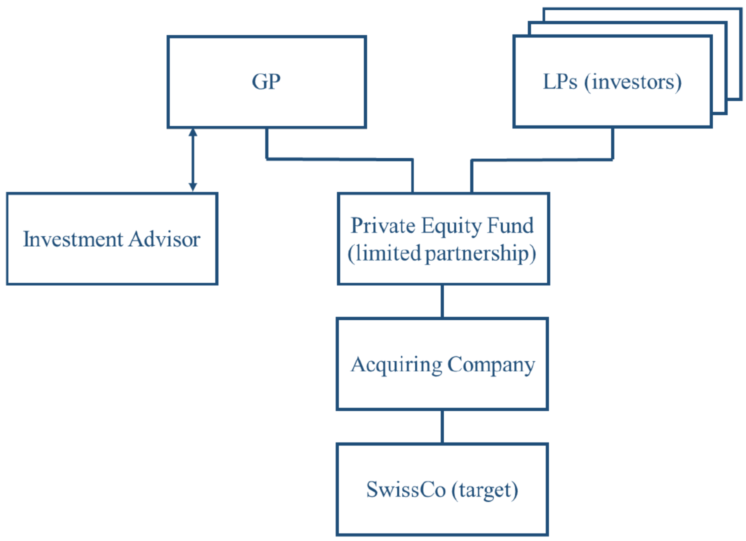
a) General Remarks; Beneficial Owner

The record-high deal activity in the private equity sector in recent years led to the acquisition of many private Swiss companies by private equity funds.

The application of the disclosure provision of article 697*j* CO caused uncertainties in the context of acquisitions by private equity funds. The key question is whether there is at all a beneficial owner within the meaning of article 697*j* CO in a private equity fund to be reported to the portfolio company (the beneficial owner is defined in 697*j* CO as "natural person for whom it [the acquirer] is ultimately acting" ("*Personen (…) für die er [der Erwerber] letztendlich handelt*")). To determine whether there is a beneficial owner within the meaning of article 697*j* CO requires a closer look on the ownership and control structure of a typical private equity fund.

b) Typical Private Equity Fund Structure: Impact on Beneficial Ownership

The typical private equity structure (which is the basis for the subsequent remarks) is as follows: At the top of the structure is a private equity fund structured in the form of a limited partnership. The investors of the fund are the limited partners (LPs) of the partnership and the administration and management of the fund is in the hands of the general partner (GP). The GP often delegates management and investment decisions of the fund to an investment advisor controlled by the partners of the private equity fund. Despite this delegation, the GP remains ultimately responsible for investments of the fund and has the power to act on behalf of the fund. A private equity fund typically invests in portfolio companies through one or several acquisition vehicles controlled by the fund. Below is a simplified overview of a typical private equity structure:



While the GP is responsible for the investment decisions and exercises control rights in the portfolio company, the GP does not economically benefit from the performance of the portfolio company (at least not directly). The investors, on the other hand, are contributors of capital and participate in the performance of the portfolio companies. However, investors typically do not have any say on the management of the fund, the investment of the funds' assets and the exercise of control rights in the portfolio company. In most cases, investors hold small positions in private equity funds which do not allow them to influence the GP in its management and investment decisions.

Economic ownership rights and control rights over the portfolio company typically fall apart in a private equity structure. According to the predominant view in legal doctrine, neither the GP nor the investors qualify as beneficial owners within the meaning of article 697*j* CO.

c) Exception: Controlling Investor(s)

Exceptionally, an investor is considered as beneficial owner, if it has a controlling influence on the private equity fund and, thus, might indirectly exercise control in the portfolio company. The same applies if not an individual investor but several investors acting in concert have a controlling influence over the private equity fund. According to a view in legal doctrine an investor should be considered as having controlling influence if it indirectly holds an interest of 25% or more in the acquired company (the 25% threshold is in line with the definition of beneficial owner in article 2*a* Anti-Money Laundering Act (AMLA)). Control of an investor may also be based on the specific contractual set up for the private equity fund.

d) Reporting of Beneficial Owners

Beneficial owners must be reported to the company within one month after an acquisition of 25% or more of the share capital or voting rights (article 697*j* (1) CO). Neither law nor legislative materials provide for provisions regarding the form in which the notification of beneficial owners has to be made. For evidentiary purposes, the notification should be made in written form.

As set out above, in a typical private equity set up there should be no beneficial owner within the meaning of article 697*j* CO to be reported to the portfolio company. However, this view has so far not been tested and a court might come to a different conclusion as to beneficial ownership in a private equity fund. Given these legal uncertainties and the severe consequences in case of non-compliance with the reporting obligation in article 697*j* CO, it is advisable that a private equity fund (through its acquisition vehicle) nonetheless makes a notification to the portfolio company (sometimes referred to as negative notification (*Negativmeldung*)).

In such notification, it is stated that there is no beneficial owner within the meaning of article 697*j* CO (unless there is a controlling investor (or several controlling investors acting in concert), in which case such investor(s) would be reported as beneficial owner(s)). To provide transparency as regards ownership and control, the notification may include a description of the organizational structure from the direct shareholder up to the private equity fund. On the level of the private equity fund, it may be confirmed that there is no investor (or several investors acting in concert) with controlling influence on the private equity fund (*e.g.*, by disclosing that there is no investor with an interest in the fund above a certain percentage threshold). The notification may also disclose the name of the highest-ranking manager of the GP, since this person may be considered as having significant controlling influence over the portfolio company (however, this information may be of limited value as over the course of time the highest-ranking manager may change).

e) Register of Beneficial Owners

According to article 697*l* CO, companies are required to keep a register of the beneficial owners reported to the company. The company (acting by its board of directors) has generally no obligation to verify the notifications of beneficial owners received from its shareholders and has no right to deviate from such notifications when maintaining the register of beneficial owners (*e.g.* by including beneficial owners in the register not reported by shareholders).

If a company receives a negative notification (*i.e.*, no person(s) reported as beneficial owner(s)) from the acquiring company of the private equity fund, it should reflect such negative notification in its register of beneficial owners. In our view, this may be done by adding a remark in the register that no beneficial owner within the meaning of article 697*j* CO exists and by making a reference to the notification received from the shareholder.

The notification (and any additional documents provided by the reporting shareholder) must be retained by the company for ten years following the deletion of the reporting shareholder from the company's share register (article 697*l* (3) CO). To ensure that notifications are not lost, they should be kept with, or attached to, the register of beneficial owners.

f) Revision under Global Forum Act

According to the current draft of the Global Forum Act, the existing article 697*j* CO is to be extended by a new article 697*j* (2), which should clarify the concept of beneficial ownership. If the direct shareholder is a legal entity or a partnership, the natural person who controls the shareholder in the meaning of article 963 (2) CO must be reported as beneficial owner (article 697*j* (2) draft CO). If there is no such person, the Global Forum Act clarifies that the shareholder must notify the company accordingly (negative notification).

In analogous application of article 963 (2) CO, the beneficial owner is the natural person who (a) directly or indirectly holds the majority of the voting rights in the direct shareholder, (b) directly or indirectly has the right to appoint or remove the majority of the members of the board of directors of the direct shareholder, or (c) can exercise a controlling influence over the direct shareholder by virtue of the articles of association, the foundation deed, a contract or comparable instruments. These criteria to determine the beneficial owner are based on exercising *control* over the shareholder.

In our view, for acquisitions by private equity funds the proposed change to article 697*j* CO means that in the future the individual(s) ultimately controlling the GP would qualify as beneficial owner(s), since the GP exercises control rights over the direct shareholder of the portfolio company. Hence, other than under current law, a beneficial owner in the sense of article 697*j* CO would also exist in typical private equity structures. As stated above, if there is/are no individual(s) controlling the GP, this fact must be reported to the portfolio company. It may be appropriate to include the name and address of the highest-ranking manager of the GP (*e.g.,* CEO, chairman of the board) in such negative notification. If in exceptional circumstances there is a controlling investor (or several controlling investors acting in concert), such investor(s) has/have to be disclosed as beneficial owner(s). Depending on the specific form of control, the controlling investor(s) would have to be reported as beneficial owners alone or together with the individual(s) controlling the GP.

3) Listed Companies

a) General Remarks; Partial Listing

The reporting obligation of article 697*j* CO only applies to companies whose shares are not listed on a stock exchange. The provision does not apply to the acquisition of shares in listed companies. Reason for the exemption for listed companies is that disclosure rules applicable to listed companies (*e.g.* article 663*c* CO and article 120 Financial Market Infrastructure Act (FMIA)) ensure sufficient transparency on beneficial owners.

According to predominate view in legal doctrine, the exemption from the reporting obligation of article 697*j* CO also applies if the acquired shares are not listed, but other equity securities (*Beteiligungsrechte*) of the company are listed on a stock exchange (*e.g.,* listed bearer shares and non-listed registered shares or vice versa). Sufficient transparency is ensured in such circumstances, because the notification obligation under article 120 FMIA is applicable and also extends to non-listed shares.

b) Listed Shareholder or Listed Parent Company of Shareholder

The wording of article 697*j* (1) CO implies that the exemption from the reporting obligation only applies if the acquired company itself is listed on a stock exchange and that the reporting obligation would apply if a listed company (directly or indirectly through a subsidiary) acquires shares in an unlisted company.

An obligation to report the beneficial owner in cases where a listed company (directly or indirectly through a subsidiary) acquires a majority interest in an unlisted company would not create any additional transparency. The same persons disclosed as beneficial owners to the listed company under applicable stock exchange law would be reported as beneficial owners to the acquired company. In line with the purpose of article 697*j* CO, which is to create transparency about the beneficial owners of unlisted companies, an exemption to the reporting obligation seems justified. The exemption also applies to all (direct or indirect) majority-controlled subsidiaries of the listed company. This view also corresponds with the AMLA according to which a financial intermediary does not have to determine the beneficial owner of a company listed on a stock exchange or a company that is majority-controlled by a listed company (see article 4 (2) AMLA).

The reporting obligation of article 697*j* CO applies if a listed company (directly or indirectly) acquires a minority interest in an unlisted company.

c) Foreign Stock Exchange

Article 697*j* CO leaves room for interpretation as to whether the exemption from the reporting obligation only applies with respect to companies listed in Switzerland or also with respect to companies listed on a foreign stock exchange (more precisely, the question is whether listed companies that are not subject to article 120 FMIA are exempted from article 697*j* CO). According to legal doctrine, the exemption from the reporting obligation applies with respect to acquired companies listed on a foreign stock exchange, if the applicable disclosure rules provide for equivalent transparency as under Swiss law. Under the conditions set out in Sec. 3b) above and provided that the applicable disclosure rules provide for equivalent transparency, the exemption also applies if the acquiring company or the parent company of the acquiring company are listed on a foreign stock exchange.

In practice, it is difficult to assess what equivalent transparency means and whether the foreign disclosure regime provides for such equivalent transparency. In our view, equivalent transparency can already be assumed if the applicable stock exchange law provisions ensure a disclosure standard which aims to effectively identify significant shareholders and their beneficial owners, even if the individual provisions are less far-reaching than Swiss stock exchange law (*e.g.* first threshold higher than 3% as provided for under article 120 FMIA). Transparency would not be sufficient if, for example, only the shareholder and not the beneficial owner(s) of such shareholder had to be disclosed under the relevant provisions. It should also be verified whether in case of a partial listing, disclosure under the respective foreign stock exchange law also extends to the non-listed shares (see Sec. 3a)).

d) Reporting of Beneficial Owners

The acquisition of 25% or more of the share capital or the voting rights in a listed company does not trigger a reporting obligation pursuant to article 697*j* CO.

As set out in Sec. 3b) above, the (direct or indirect) acquisition of a controlling interest in an unlisted company by a listed company should be exempted from the reporting obligation. However, due to legal uncertainties associated with such interpretation of article 697*j* CO, a notification should be made to the company, in which it is disclosed that the shares of the acquirer (or the parent company of the acquirer, as the case may be) are listed on a stock exchange. The notification may include information providing additional transparency on the listed company and the applicable disclosure regime, such as the following: stock exchange where the shares of the company are listed, lowest threshold triggering a disclosure obligation under applicable stock exchange laws, list of shareholders exceeding lowest notification threshold at the time of the notification and reference to where updated disclosure notifications and a list of important shareholders may be found (*e.g.* link to the relevant website of SIX or the listed company). Besides that, it is not necessary to state the beneficial owner(s) of the listed company. Such a notification should also be made in case of an acquisition of a minority interest in an unlisted company by a listed company.

If the company is listed on a foreign stock exchange and the applicable disclosure rules are deemed not to be equivalent to the Swiss disclosure rules, the beneficial owner(s) of the listed company will have to be disclosed to the acquired company.

e) Register of Beneficial Owners

The register of beneficial owners of the company receiving a notification will reflect the fact that the shares of the shareholder (or its parent company as the case may be) are listed on a stock exchange. Additional information regarding the listed company and its ownership disclosed in the notification (see Sec. 3d)) may be summarized in the register of beneficial owners. Alternatively, a reference to the notification is made in the register of beneficial owners.

f) Revision under Global Forum Act

The revision clarifies that an exemption to the reporting obligation applies if only part of the equity securities of a company are listed on a stock exchange, even if the acquired shares are not listed (article 697*j* (1) draft CO; replacement of the wording "shares" (*Aktien*) by "equity securities" (*Beteiligungsrechte*)).

In addition, the revision of article 697*j* CO intends to eliminate the ambiguities with regard to acquisitions by listed companies (or by companies controlled by listed companies). Under the proposed changes, a shareholder whose equity securities are listed on a stock exchange and a shareholder who is controlled by a listed company within the meaning of article 963 (2) CO or who controls such a company must only report this fact and the name and registered office of the listed company (article 697*j* (3) draft CO).

The dispatch on the Global Forum Act states that this also applies to a listing abroad, provided that equivalent transparency is guaranteed. Since the dispatch does not further elaborate on this, the difficulties connected with the assessment of equivalence (see Sec. 3c)) remain even after the revision of the law.

4) Change of Beneficial Owner without Transfer of an Unlisted Companies' Shares

Pursuant to article 697*j* (2) CO, any shareholder who had to report its beneficial owner(s) has to report any change in the name or the address of the beneficial owner to the company. The law does not provide for a term for the fulfilment or for legal consequences in the event of non-compliance with this obligation. In our opinion, due to the lack of a specified term, a breach of this obligation has no consequences.

The scope of said provision is rather unclear. What is clear is that the changes specified in article 697*j* (2) CO (*i.e.*, changes to the first name, last name or the address of the beneficial owner) must be reported to the company. Further, in accordance with prevailing legal doctrine, it can be assumed that other changes at the level of the beneficial owner (*e.g.* change of the level of shareholding) do not have to be reported to the company.

In practice, the situation in which the beneficial owner changes without a transfer of shares in the unlisted company causes difficulties. For illustrative purposes, we assume a beneficial owner (BO) who sells to a third party all shares in a wholly owned subsidiary (SubCo), which in turn holds 25% or more of the share capital or voting rights of an unlisted Swiss company (SwissCo). As mentioned above, in such case only the BO changes but not SubCo as direct shareholder entered in the share register of SwissCo. According to the wording of article 697*j* (1) CO, there is no reporting obligation in this case due to the lack of an acquisition of shares in SwissCo.

It is questionable whether in such cases there is a reporting obligation regarding the change of the BO based on article 697*j* (2) CO. The provision refers to a "change in the first or last name or address of the beneficial owner" ("*Änderung des Vor- oder Nachnamens oder der Adresse der wirtschaftlich berechtigten Person*"). Such a change also occurs in our initial case. With a view to the relevant dispatch, however, it can be assumed that the legislator did not want to introduce an additional reporting obligation in article 697*j* (2) (besides article 697*j* (1)) (note though, that recent views in legal doctrine take the view that such a reporting obligation exists).

Even if this view would be preferable in order to ensure the envisaged transparency, in our view no reporting obligation arises *de lege lata* in our initial case where only the BO changes but no transfer of shares of the SwissCo occurs. Article 697*j* (2) only deals with the change in the personal details of the BO already reported pursuant to article 697*j* (1). This conclusion is also supported by the practical problem that SubCo may not know and may not have the means to ensure timely knowledge of all changes of its beneficial owner(s).

5) Maintaining the Register of Beneficial Owners

As counterpart to the reporting obligation of shareholders, companies a required to maintain a register of beneficial owners (article 697l CO). The law does not make any specifications as to the form of such register. The register may be combined with the share register (*e.g.*, by adding additional columns to the share register) or kept as a separate register (*e.g.,* by annexing the register of beneficial owner to the share register). The register of beneficial owners has to contain first name, last name and address of the individuals reported to the company as beneficial owners (article 697l (2) CO). According to the wording of the law, the company is obliged to keep the register of the beneficial owners reported to the company. Within a company, this obligation is in principle imposed on the board of directors.

It is unclear when the obligation for companies to first "create" a register of beneficial owners is triggered. The questions arises, because holders of registered shares are not required to report their beneficial owner(s) if they held 25% or more of the share capital or the voting rights of a company already prior to the entry into force of the disclosure provisions on July 1, 2015. Consequently, many companies with registered shares have to date not received any notifications from their shareholders because no transfers in their shares triggering the notification obligation have occurred since then. Article 697l CO does not exempt companies from maintaining a register in such circumstances. However, in our view the wording "of the beneficial owners notified to the company" ("*die der Gesellschaft gemeldeten wirtschaftlich berechtigten Personen*") in article 697l (1) CO indicates that the obligation is only triggered upon receipt of a (first) notification of beneficial owners. It does not create any transparency if prior to the first notification, companies maintain an empty register of beneficial owners. This problem should not arise with regard to companies with bearer shares, since holders of bearer shares had to notify their beneficial owners to the company within one month after coming into force of the provisions on July 1, 2015 and the company then entered such beneficial owner in the register.

Alexander Wille (alexander.wille@lenzstaehelin.com)
Lukas Held (lukas.held@lenzstaehelin.com)

Share Buy-backs – Reloaded
Insights into Selected Areas of Publicly Announced Share Buy-backs by Swiss Companies

Reference: CapLaw-2019-17

Arbitrageurs are important players in the buy-back market, primarily because of certain tax considerations. One important driver is the repurchase price a company is permitted to offer in a share buy-back. Particular attention should be placed to secondary market transactions during a share buy-back (*e.g.*, sales of ADRs). Novelties include VWAP-based buy-back programs and buy-backs executed via Dutch auction.

By Hansjürg Appenzeller / Dieter Grünblatt

There are various purposes and economic reasons to buy back shares, *inter alia* the following:

– The buy-back of own shares for subsequent cancellation can be used as an instrument of capital management and distribution policy, particularly to distribute surplus funds to shareholders as an alternative to dividends; as an additional effect, upon their cancellation, the number of outstanding shares is reduced and, thus, the earnings per share of the remaining outstanding shares are increased.

– Shares may be bought-back for purpose of treasury or market liquidity; the company's ability to buy back a certain number of its own shares tends to improve liquidity in a tight stock market (*e.g.*, price smoothing, market making, proprietary trading).

– Shares can further be bought-back for other reasons, such as defense against a hostile takeover, to cover convertible bonds or for satisfaction of delivery obligations under an employee participation program or stock option plan.

Share buy-backs of Swiss companies can be executed in many ways. They are subject to corporate law requirements, Swiss insider and market manipulation regulations and tax consequences as well as, if publicly announced, to tender offer rules. There are certain common rules applicable to all share buy-backs. In relation to each variation of purpose, specific or additional considerations, requirements and limitations apply.

This article gives an insight into selected areas of publicly announced share buy-backs by Swiss companies, focusing on repurchases of own shares over a second trading line for purpose of cancellation.

1) Share Buy-back for Purpose of Cancellation

a) Players in the Buy-back Market

In principle, share buy-backs may be executed on the regular trading line or a second trading line. However, if shares are bought back for purpose of cancellation, the shares will be deemed liquidated for Swiss tax purposes, and the company buying back the own shares will be liable to 35% Swiss withholding tax (*Verrechnungssteuer*) on the difference between the purchase price and the nominal value of the shares, except if the shares are bought back against reserves from capital contributions (*Kapitaleinlagereserven*), which can be repaid free of withholding tax to the shareholders.

If a company buys back shares on the regular trading line from anonymous sellers against reserves other than reserves from capital contributions, it will not be able to deduct the 35% withholding tax from the purchase price, as required by the Swiss withholding tax legislation, and hence be liable to withholding tax on the grossed-up amount, resulting in an effective withholding tax rate of 53.8% for the company. To avoid this prohibitive tax consequence, a company buying back its own shares for purpose of cancellation against reserves other than capital contribution reserves must use a second trading line, where it is the only buyer, and hence will be able to deduct the 35% withholding tax on the difference between the purchase price and the nominal value as required by the withholding tax legislation.

A sale on the second trading line is unattractive for shareholders who are private individuals resident in Switzerland for income tax purposes and also for shareholders who are resident outside Switzerland:

– In the first case, the withholding tax is fully refundable or creditable against income tax. However, irrespective at which price the individual has purchased a share he or she sold into the buy-back, the *full* difference between the buy-back price and the nominal value of that share will be considered taxable income to such person (except if, and to the extent, the share has been bought back against reserves from capital contributions) while a sale on the regular trading line will normally be a tax-exempt private capital gain (or loss) for such person.

– In the second case, the 35% withholding tax may be refundable under an applicable double taxation treaty of Switzerland and the country of residence of the selling shareholder to a residual tax of ordinarily 10% or 15%, and exceptionally to a residual tax of 5%, or nil in case the selling shareholder is a pension fund or a shareholder holding directly 10% or 15% percent of the capital of the company buying back the shares, however, in any case subject to the selling shareholder complying with the typically disliked refund procedures.

Therefore, these shareholders will normally not participate in a second trading line buy-back program and the group of sellers on the second trading line is naturally reduced to Swiss domestic *corporate* investors who (i) can fully reclaim the withholding tax deducted and (ii) are taxable only on the spread and usually can claim nevertheless participation relief if the shares sold aggregate a value of at least CHF 1m.

In fact, sellers are normally limited to a few financial institutions in Switzerland, acting as arbitrageurs with access to the stock exchange and technical systems, allowing them to efficiently purchase on the liquid regular trading line and sell on the second trading line for a spread (economically, a spread, if any, may cover financial costs for the cash out until refund of the withholding tax and administrative costs for claiming the refund).

Selling shareholders may also include institutional investors who can liquidate investments in shares over the second trading line instead over the regular trading line to benefit from a turnover tax-exempt transaction and from participation relief (or tax exemption in case of certain institutional investors).

b) New Tax Regime

Under the current withholding tax law, Swiss companies are completely free to choose whether to pay dividends out of taxable retained earnings or taxable reserves or tax-free reserves from capital contributions. The same choice applies for the buy-back of shares.

However, the Act on the Tax Reform and the Funding of the Social Security System, which has been approved by the Swiss people on the popular vote held on May 19, 2019, introduces a 50:50 distribution rule for (at least) 50% taxable reserves and 50% reserves from capital contributions. The new distribution rules will enter into force as of January 1, 2020.

Under the 50:50 distribution rules distributions out of reserves from capital contributions made by companies *listed* in Switzerland (including share buy-backs against reserves from capital contributions) will only benefit from the tax-free withholding tax treatment (and tax-free income tax treatment for Swiss resident private investors) if and to the extent that the company distributes a taxable dividend in the same amount, provided that the company has taxable retained earnings and taxable reserves. Accordingly, a listed company buying-back shares for cancellation against reserves from capital contributions will have to use as of January 1, 2020 for the buy-back of own shares at least 50% taxable retained earnings or taxable reserves.

c) Pricing Considerations to Address Market Manipulation Concerns

The amount of the spread a company may offer to sellers of shares over the second trading line is limited by Swiss market manipulation regulations. A company buying back its own shares must ensure that it does not violate the general market conduct rules and criminal provisions pursuant to articles 142 and 143 of the Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading Act (FMIA) and articles 154 and 155 FMIA, respectively.

The rules relating to market manipulation (article 143 FMIA) or price manipulation (article 155 FMIA) are deemed to be adhered to if the share buy-back has a demonstrable economic background that corresponds to genuine bid and ask behaviour (see FINMA Circular 2013 | 08 on Supervisory Rules for Market Conduct in Securities Trading (FINMA Circular 2013 | 08), note 38, see also Message of the Federal Council, BBl 2011 6873, p. 6903). However, where the intended purchases and | or repurchases are technically executed by using nostro-nostro in-house crosses, they must be matched in the stock exchange system independently of one another and without any previous agreement (see FINMA Circular 2013 | 08, note 35).

In respect of the discussion of inadmissible market behaviour and market manipulation (article 143 FMIA), the phrase "misleading signals regarding the supply, demand or price of securities" in article 143(1)(b) FMIA is relatively opaque. While articles 122 through 128 of the Ordinance on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading (FMIO) are intended to provide for an *exhaustive list* of cases in which behaviors which fall under article 142 FMIA and article 143 FMIA are admissible, the cited provisions in general, and article 123 FMIO (buy-back of own equity securities) in particular, do not generally exempt transactions that have a demonstrable economic background corresponding to genuine bid and ask behaviour. The FINMA Circular 2013 | 08, note 38, and the Federal Council's Message to the preceding provisions, however, are more lenient with respect to these situations. Because of this deviation between the FMIO on the one side and the FINMA Circular 2013 | 08 on the other side and the broad wording in the FMIA itself, an element of uncertainty remains. However, the fact that FINMA is the enforcing authority for regulatory market conduct rules (article 6 of the Financial Market Supervisory Authority Act), we would expect that FINMA would generally apply the practice and standards as set forth in its Circulars.

As far as the spread a company may offer to sellers of shares over the second trading line is concerned, the FMIO provides a safe harbor regulation from the market conduct and behavior rules if, among others, certain specific restrictions on pricing are considered. Generally speaking, the price paid on the second trading line may not be higher than (article 123(1)(d) FMIO):

- the last independent closing price on the regular trading line; or
- the current best independent offer price on the regular trading line, if it is lower than the closing price as described in the previous bullet point.

However, article 123(4) FMIO stipulates the assumption that the market conduct and behavior rules are not violated if the price paid on the separate trading line, *i.e.*, where only the bank (or the bank or securities dealer appointed to implement the buy-back) is permitted to post buy orders in the order book (separate trading line), is a maximum of 2% higher than:

- the last closing price achieved on the regular trading line; or
- the best current bid price on the regular trading line, provided this is below the price referred to in the previous bullet point.

In any event, the company may not enter any buy order during the opening and closing auctions, nor during an auction performed by the exchange after a "stop of trading".

2) Beware of Secondary Market Transaction Restrictions

The rules relating to market manipulation require that the company, and any of its affiliates or representatives acting in the name and on behalf of the company, do not execute transactions or acquisition or disposal orders which could give false or misleading signals regarding the supply, demand or price of the securities. Share buy-backs and other secondary market transactions in own shares could fall under these conduct rules. Article 123 FMIO contains safe harbor provisions which permit such transactions even though they could potentially constitute market manipulative behavior. In order to be exempted from the market manipulation rules, secondary market transactions in equity securities, within or outside the share buy-back program, must comply with – besides the pricing requirements (see section 1c) above) – the reporting requirements and volume restrictions set out in article 123(1) FMIO and circular no. 1 "Buy-back Programmes" of the Swiss Takeover Board dated June 27, 2013 (status as of January 1, 2016, the TOB Circular No. 1).

a) Scope of Application

The market manipulation (article 143 FMIA) or price manipulation (article 155 FMIA) rules apply to all securities admitted to trading on a trading venue in Switzerland. For the purposes of the FMIA, the term "securities" means standardized certificated and uncertificated securities, derivatives and intermediated securities, which are suitable for mass trading (article 2(b) FMIA; see also article 3(b) of the new Financial Services Act (FinSA), enacted by the Swiss Parliament on June 15, 2018 and currently expected to enter into effect on January 1, 2020). Therefore, trading in securities (*e.g.*, shares, bonds, etc) and derivatives (defined as "*financial contracts whose value depends on one or several underlying assets and which are not cash transactions*", see article 2(c) FMIA) which are admitted to trading on a trading venue in Switzerland is subject to the market conduct rules under the FMIA.

By contrast, only transactions in equity securities benefit from, and are included in, the safe harbor provisions contained in article 123 FMIO. The term "equity securities" relates to shares, participation certificates, profit-sharing certificates or other participation rights (article 2(i) FMIA and article 2(a) of the Ordinance of the Takeover Board on Public Takeover Offers of August 21, 2008 (TOO); see also article 3(a)(1) FinSA). Therefore, from the letter of the law, one could conclude that transactions in securities other than equity securities are not permitted under the market manipulation rules. This conclusion falls short of a systematic view, however.

In general, Swiss capital markets laws treat equity-linked securities and equity securities alike (*e.g.*, disclosure of shareholdings pursuant to article 120 FMIA; equal treatment and transaction reporting during a public tender offer pursuant to article 9 TOO and articles 38 *et seq.* TOO, respectively). The same should be true if the scope of the safe harbor provisions contained in article 123 FMIO is defined. Securities whose value are derived, to a certain extent, from the value or performance of equity securities should also benefit from the safe harbor provisions. This applies to equity derivatives as defined in article 15 of the Financial Market Infrastructure Ordinance of the Financial Market Supervisory Authority FINMA dated December 3, 2015, such as conversion rights (*e.g.*, convertible bonds), purchase rights (*e.g.*, call options) and disposal rights (*e.g.*, put options), as well as to other financial instruments the performance of which depends, fully or partly, on the performance of equity securities like American depository receipts (ADRs).

Extending the scope of the safe harbor means, by contrast, that the reporting and volume restrictions apply not only to equity securities but also to equity-linked securities.

b) Purchases: Reporting Requirements and Volume Restrictions

Purchases of equity or equity-linked securities during a buy-back program are only permissible if the reporting requirements and volume restrictions set out in article 123(1) FMIO and the TOB Circular No. 1 are complied with.

During a buy-back program, the company must publish, on its website at the latest on the fifth trading day following their execution, purchases of equity or equity-linked securities whether executed within or outside of the buy-back program.

Further, the scope of purchases may not exceed 25% per day of the average daily volume traded during the 30 days prior to the publication of the buy-back (article

123(1)(c) FMIO). The number relevant for this 25% threshold is fixed at the time of publication of the buy-back notice and equals the sum of transactions on the regular trading line – both within and outside of the order book at the stock exchange – divided by the number of trading days in the 30 calendar days before publication of the buy-back notice (TOB Circular No. 1, note 23a). Given the extension of the scope of application set out above, companies are well advised to take into account all the secondary market purchases of equity and equity-linked securities whether executed within or outside of the buy-back program. This means, for instance, purchases of shares on the regular trading line outside the buy-back should – together with the purchases within the buy-back program over a second trading line – be considered for the 25% volume restriction.

The volume restriction can be an obstacle for companies whose shares have a low trading volume, as the permitted buy-back volume may result to be insignificant. In such case, the company has no other choice but to obtain an exemption from the Swiss Takeover Board (the TOB) pursuant to article 123(3) FMIO. As such exemption cannot be obtained in the reporting procedure, the company has to obtain formal approval from the TOB.

c) Sales: Reporting Requirements and other Restrictions

Sales of own equity or equity-linked securities during the buy-back program are only permitted if they are made solely to fulfil delivery obligations under employee participation programs. Alternatively, such sales are permissible under the safe harbor rules if they meet the following conditions:

- they are reported to the stock exchange on the trading day following their execution,
- they are published by the company no later than the fifth trading day after their execution, and
- their scope does not exceed 5% of the average daily volume traded on the regular trading line during the 30 days prior to the publication of the buy-back.

These conditions also apply in case of selling equity or equity-linked securities for hedging purposes even if there is a firm intent to repurchase them later for delivery to employees. Such sale transactions do not qualify as being made solely to fulfil delivery obligations under employee participation programs.

The foregoing does, however, not mean that all sales of equity or equity-linked securities are permissible. There might be other restrictions (*e.g.*, under foreign law) which apply to specific securities such as ADRs.

ADRs are generally treated like shares for purposes of the market manipulation and price manipulation rules applicable during a share buy-back program. Accordingly, they benefit from the safe harbor rules contained in article 123(1)(f) FMIO and their sales are permitted from the point of view of Swiss capital markets laws. However, secondary sales of shares (or ADRs) in the market involving U.S. jurisdictional means (*e.g.*, U.S. stock exchange) might need to be registered with the U.S. Securities Exchange Commission (SEC) (an exemption should be available for sales of ordinary shares if they occurred on a Swiss stock exchange). Such sales present a potential violation of section 5 of the U.S. Securities Act of 1933, as amended, which requires every offer and sale of a security involving U.S. jurisdictional means to be registered with the SEC unless an exemption is available. Sales by a company or any of its affiliates would not ordinarily satisfy exemptions available in the case of ordinary secondary market transactions in securities issued by others (*e.g.*, ADRs). If sales do not comply with the registration requirements, the seller would be strictly liable to purchasers. A purchaser needs only show that the securities were subject to registration but unregistered, that he or she bought the securities and that the defendant was the seller thereof. Recovery would be limited to rescission or, if the plaintiff no longer owns the security, damages based upon the difference between the purchase price and the plaintiff's resale price. Such a claim would need to be brought within one year of the alleged violation. In addition, section 5 violations could be subject to potential enforcement actions by the competent authorities.

d) Exempted Transactions

Notwithstanding the foregoing, certain secondary market transactions executed during a buy-back must be permissible without being subject to the reporting requirements and volume restrictions contained in article 123(1) FMIO and the TOB Circular No. 1. While there is no specific exemptions in the law, the following transactions should be exempt from the volume restrictions and reporting requirements:

- market making for the purpose of facilitating client orders and ensuring liquidity in securities on both buy and sell sides to, where appropriate, reduce the bid/ask spread without moving the price of the securities against the market trend or fixing prices artificially, each in compliance with the market conduct rules set forth by FINMA (*see* FINMA Newsletter 52 (2013) dated November 18, 2013 "Trading own equity securities with the purpose of ensuring liquidity under the new provisions on market manipulation"), if booked on the trading book;

- purchases and sales of equity or equity-linked securities if they are executed exclusively in order to fulfil delivery obligations under an employee participation program; and

- trading as client dealers in securities in the own name but for the account of clients.

3) VWAP-Based Buy-back Program

As set out in section 1a) above, a Swiss company which executes a share buy-back program for purpose of cancellation is obligated to pass on the withholding tax at a rate of 35% on the difference between the repurchase price, on the one hand, and the nominal value plus reserves from capital contributions, which is reduced or used in the course of the cancellation of shares upon the resolution of the general meeting of shareholders, on the other hand, to the sellers. To that end, share buy-back transactions for purpose of cancellation are executed over a second trading line. Shares are usually sold over the second trading line by financial investors (banks or securities dealers) which are entitled to a full refund of the withholding tax. It is the standard practice that the financial investors acquire the shares over the first trading line and sell them over the second trading line to the company (arbitrage business).

For certain Swiss domestic companies, whose shares are solely listed on a foreign stock exchange, the Swiss Federal Tax Administration permitted volume weighted average price (the VWAP) based buy-back programs bilaterally agreed between the executing agent and the company. However, such bilaterally agreed VWAP-based buy-back programs are not generally permitted for Swiss listed companies. They could be permissible if structured not as a sales agreement or a series of sales agreements with the company (such as in case the company is solely listed on a foreign stock exchange) but as a mandate.

Therefore, VWAP-based buy-back programs for Swiss listed companies are usually structured as follows:

- The company mandates a bank or securities dealer (the Agent) to execute the share buy-back over a second trading line.
- This mandate includes a delegation of the execution of the share buy-back to the Agent in accordance with article 124(2)(a) and article 124(3) FMIO.
- The Agent, on behalf of and for the account of the company, independently executes repurchases on the basis of trading parameters determined by the company (the Trading Parameters) during a pre-defined trade period; after a match of the bid and ask price on the second trading line, the Agent pays to the seller of the shares the net price (*i.e.*, the repurchase price less deducted applicable withholding taxes) for the shares with funds on an account of the company; the company is responsible for paying the applicable withholding taxes to the Swiss tax authorities.
- The special feature of this mandate is that the Agent receives a compensation if it manages to buy back shares at a better price per share than the arithmetic mean of the daily VWAP of the shares on the ordinary trading line over the term of the mandate agreement. The arithmetic mean of the daily VWAP is inevitably higher than its

average purchase price since the average purchase price is volume-weighted, while the arithmetic mean of the daily VWAP is not volume-weighted.

4) Dutch Auctions

In its practice, the TOB confirmed the legality of so-called Dutch auctions in order to determine the buy-back price. In a Dutch auction, the repurchase price is identical for all tendering shareholders and within a price range set by the company.

The Dutch auction includes the following features:

- In view of determining the repurchase price, each shareholder willing to tender its shares in the buy-back indicates, within the price range and buy-back period (usually ten days) fixed by the company, how many shares such shareholder wishes to sell at which price (the Sale Offer).

- The repurchase price will be set identically for all tendering shareholders on the basis of all Sale Offers submitted so that the entire planned buy-back volume can be placed and the shares can be acquired by the company at the lowest possible price.

- The tendering shareholders are able to sell their shares at the price determined in the Dutch auction which is either at the price indicated by them in the Sale Offer or below. Sale Offers of shareholders at a price above the determined repurchase price will not be accepted by the company.

- If not all shares tendered by shareholders can be repurchased at the price determined in the Dutch auction because the maximum buy-back volume is exceeded, the shares tendered by each shareholder at the level of the determined price will be reduced proportionally.

According to the TOB, the Dutch auction combines elements of a fixed price offer and a buy-back at market price. Depending on whether elements of a fixed offer or market price offer prevail, the TOB treats the buy-back as a buy-back at a fixed price or at market price. Buybacks at a fixed price constitute partial public tender offers which must be open for a minimum period of ten trading days and which are submitted at a specific price. Buybacks at market price represent transactions in which the company announces its intention to buy back on the ordinary trading line or on a second trading line. They last for a maximum of three years and are carried out at a price determined in accordance with the matching rules of the relevant share exchange. Furthermore, in the case of buy-back at market price, the company is not obliged to acquire the securities tendered to it.

In the matter of AP Alternative Portfolio AG, the TOB held that elements of a buy-back at fixed price prevailed since the offer period and the price floor included in the buy-back as well as the identical price paid to each shareholder selling shares warranted a qualification of the buy-back as at a fixed price. As a result, pursuant to the Swiss takeover laws, the buy-back price would need to be fixed at the time the buy-back is announced. However, the TOB granted an exemption to that rule, holding that the Dutch auction complied with the principles of equal treatment, transparency and integrity. The TOB reasoned that the price of the buy-back was sufficiently determined given the price floor and the resulting knowledge of each shareholder of the lowest possible price. The fact that the price could indeed be higher after the auction had taken place was deemed permissible. In a later case, the TOB exempted a share buy-back program from the obligations of the TOB Circular No. 1 subject to the condition that the company is not allowed to be informed about the status, amount and price of the shares tendered by shareholders or to gather any such related information in any other way during the duration of the share buy-back program from the executing bank. This is to ensure that the company cannot influence the repurchase price.

Hansjürg Appenzeller (hansjuerg.appenzeller@homburger.ch)
Dieter Grünblatt (dieter.gruenblatt@homburger.ch)

Public Exchange Offer for Panalpina

Reference: CapLaw-2019-18

On 1 April 2019, DSV A/S, Hedehusene, Denmark and Panalpina Welttransport (Holding) AG, Zurich, Switzerland, have entered into an agreement on the terms and conditions of a combination by way of a public exchange offer by DSV for all publicly held registered shares of Panalpina for approximately CHF 4.6 billion. The board of directors of Panalpina has resolved to support the public exchange offer by DSV and to recommend the acceptance of DSV's public exchange offer to its shareholders. Panalpina's three major shareholders, who in total hold approximately 70% of the share capital in Panalpina, have committed to tender their Panalpina shares into the exchange offer.

IPO of Stadler

Reference: CapLaw-2019-19

Stadler Rail AG, a leading global pure-play producer of rolling stock and related systems, successfully priced its IPO and listed its shares on the SIX Swiss Exchange. The offering consisted of 35,000,000 shares with an over-allotment option of 5,250,000 shares, all of which were offered (directly and indirectly) by Peter Spuhler. The price for the offered shares was set at CHF 38.00. Trading in the shares started on 12 April

2019. On 16 April 2019, the Joint Global Coordinators (Credit Suisse and UBS), acting on behalf of the syndicate banks, have exercised the full over-allotment option at CHF 38.00 per share. Including the shares placed in connection with the over-allotment option, a total of 40,250,000 existing shares have been sold in the IPO of Stadler, corresponding to 40.25 per cent of the share capital. The total placement volume therefore amounts to CHF 1,530 million.

IPO of Medacta

Reference: CapLaw-2019-20

On 4 April 2019, Medacta Group SA, a pure play orthopaedics company, opened the IPO-season 2019 at SIX Swiss Exchange with the first day of trading of its shares. The shares of Medacta were priced at CHF 96.00 per share and on 3 May 2019, Medacta announced that the Joint Global Coordinators (Credit Suisse and Morgan Stanley) have partially exercised the over-allotment option in the amount of 438,472 existing shares at the offer price. Including the shares placed in connection with the over-allotment option, a total of 6,138,472 existing shares have been sold in the IPO, increasing the free float to 30.7%, with the Siccardi family holding 69.3% of Medacta's share capital. The total placement volume amounts to CHF 589 million.

Spin-off of Novartis' Alcon Business and Listing of Alcon Shares on the SIX and the NYSE

Reference: CapLaw-2019-21

Alcon Inc., the largest eye care device company in the world, with complementary businesses in surgical and vision care, announced its debut as an independent, publicly traded company and the completion of its separation from Novartis on 9 April 2019, the day the company's shares began trading on the SIX Swiss Exchange and New York Stock Exchange (NYSE). The Alcon shares are also included in the Swiss Market Index (SMI). In light of Alcon's market capitalization of more than CHF 28bn (at close of trading on SIX on the first day of trading), it was the largest spin-off and listing on the SIX in a decade at least.

The spin-off has been effected through a tax-neutral dividend-in-kind distribution of Alcon shares to holders of Novartis shares and ADRs (American Depositary Receipt) that was previously approved by Novartis shareholders. It has been preceded by the complete legal and structural separation of the Alcon business into a standalone company through a series of transactions.

Under the terms of the separation, each Novartis shareholder or ADR holder received one Alcon share for every five Novartis shares or ADRs they held as on the record date for the distribution.

St. Gallen Corporate Law Day (St.Galler Gesellschaftsrechtstag)

Thursday, 23 May 2019, SIX ConventionPoint Zurich

https://irphsg.ch/weiterbildung/tagungen/2019-2/st-galler-gesellschaftsrechtstag-2019/

Seminar "16th Zurich Conference on Developments in Financial Market Law" (Seminar "16. Zürcher Tagung zu Entwicklungen im Finanzmarktrecht")

Tuesday, 4 June 2019, Lake Side, Zurich

http://www.eiz.uzh.ch/weiterbildung/seminare/

SZW Corporate Law Convention 2019 (SZW-Tagung zum Aktienrecht 2019)

Tuesday, 4 June 2019, University of Zurich

https://www.szw-tagung.ch/

7th Annual URPP Conference, FinSA/FinIA: The Financial Centre Facing New Challenges (7. Jahrestagung des Universitären Forschungsschwerpunkts Finanzmarktregulierung UZH, FIDLEG/FINIG: Der Finanzplatz vor neuen Herausforderungen)

Wednesday, 5 June 2019, Rechtswissenschaftliches Institut der Universität Zürich

https://www.finreg.uzh.ch/en/events.html