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The Federal Supreme Court Rules on Nominees' Disclosure Obligations

Reference: CapLaw-2014-1

On 29 July 2013, the Federal Supreme Court decided on article 9(2) SESTO-FINMA, one of the provisions whereby FINMA intended to implement the regulation set forth in article 20 SESTA on disclosure duties for substantial positions in companies listed in Switzerland. The Federal Supreme Court ruled that article 9(2) SESTO-FINMA has no legal basis in the SESTA to generally require notifications to the stock exchange and the companies by nominees acquiring or selling equity securities for the account of several beneficial owners that are independent of each other. The consultative draft of the Financial Market Infrastructure Act would provide for an express legal basis for such disclosure, if enacted.

By Benjamin Leisinger

1) Facts of the Case

X. LLC (X.), a company domiciled in the US is the parent company of an international group providing services in asset management and investment advice and managing an important set of funds. As part of its business, X. and its subsidiaries invest in companies listed on the SIX Swiss Exchange Ltd. (SIX). X. is held by two classes of shareholders, Class A and Class B. On 18 December 2009, X. and another company, A. Ltd. (hereinafter A.), a company whose investment positions have partially been held by shareholders of Class B of X., filed a request for a ruling with the Disclosure Office (DO) of the SIX based on article 20(6) of the Stock Exchange Act (SESTA), requesting a finding that the two companies were not acting in concert and could calculate and notify, if required, their interests independently of one another. On 24 March 2010, the DO granted this request.

However, the DO also held that the shareholders of Class B of X. formed an organized group controlling X. and, therefore, they were indirect holders of holdings managed by X. As a consequence, they should declare these holdings on a consolidated basis with their own interests.

X. and A. have unsuccessfully objected against this recommendation at the Financial Market Supervisory Authority FINMA (FINMA). By decision of 17 August 2011, FINMA rejected the appeals and, *inter alia*, stated that X. and its subsidiaries should indeed be classified as beneficial owners of shares they managed, and that the fact that they were not the owners would not be relevant.

X. appealed against this decision to the Federal Administrative Court. By judgment of 6 December 2012, it also dismissed the appeal. It noted that the nominees' obligation to report under article 9(2) of the Ordinance of FINMA on Stock Exchanges and Securities Trading (SESTO-FINMA) was consistent with the meaning of article 20(1) SESTA and that the shareholders of Class B of X. were able to decisively influence the decision-making of X. and its subsidiaries, including how they decide to manage interests of their clients and exercise the voting rights attached to it. The Federal Administrative Court accordingly also found that the shareholders of Class B qualified as an organized group controlling the decision-making of X. and were subject to the reporting requirement under article 9(2) SESTO-FINMA.

On 29 January 2013, X. filed an appeal with the Federal Supreme Court against the Federal Administrative Court's judgment. The Federal Supreme Court decided on 29 July 2013 that the Federal Administrative Court's judgment should be set aside and found that article 20 SESTA compels neither X. nor its subsidiaries, nor holders of Class B of X. to notify the holdings of the beneficial owners within the portfolio managed by X. and its subsidiaries (2C_98/2013).

2) The Federal Supreme Court's Considerations

In the Federal Supreme Court's opinion, the dispute only concerned the question of whether X. holds the positions "for its own account" within the meaning of article 20(1) SESTA and is therefore obliged to notify the holdings of its customers, of which it is only the manager that freely exercises the voting rights attached to these holdings.

The decision focused on two aspects: first, the requirement for X. and its subsidiaries to declare their own positions together with their clients' interests ("consolidation down") and, second, the obligation to then consolidate these positions with those held by its shareholders of Class B ("building up"). The Federal Supreme Court's decision mainly is of interest regarding the consolidation down.

According to article 20(1) SESTA, whosoever directly or indirectly or acting in concert with third parties acquires or sells for their own account securities or purchase or sale rights relating to securities in a company domiciled in Switzerland whose equity securities are listed in whole or in part in Switzerland, or a company not domiciled in Switzerland whose equity securities are mainly listed in whole or in part in Switzerland, and thereby attains, falls below or exceeds the threshold percentages of 3, 5, 10, 15, 20, 25, $33^1/_3$, 50 or $66^2/_3$ of voting rights, whether or not such rights may be exercised, must notify the company and the stock exchanges on which the equity securities in question are listed. Pursuant to article 20(5) SESTA, FINMA shall issue rules relating to the scope of the obligation to notify, the treatment of share acquisition and sale rights, the calculation of voting rights and the time limits within which the obligation to notify must be fulfilled and a company must publish changes in its ownership structure pursuant to article 20(1) SESTA. FINMA issued these rules in the SESTO-FINMA.

Under article 9(2) SESTO-FINMA, the obligation to notify also applies to those who, by the acquisition or sale of equity securities for the account of several beneficial owners independent of each other, reach, exceed or fall below the threshold percentages and are entitled to exercise voting rights to that extent. Article 9(3)(d) SESTO-FINMA clarified that the granting of a power of attorney exclusively for representation at a single general meeting of shareholders does not trigger a reporting obligation by the agent.

The Federal Supreme Court recalled that the duty to notify the stock exchange and the relevant company set forth in SESTA is unique and does not attach to civil law relations. Rather, the economic situation is decisive.

The Federal Supreme Court stated that where the statutory text is clear, the relevant authority should apply the law and cannot depart therefrom unless there are reasonable grounds to believe that the text does not fit in all respects to the true meaning of the provision in question and leads to results that the legislature could not have intended and that offend the sense of justice or the principle of equal treatment. It stated that such patterns may result from preparatory work, the basis and purpose of the requirement at issue, as well as the relevant provision's relationship with other provisions.

At first glance, the Federal Supreme Court held, the text of the provision is clear: it does *not* require persons or entities holding interests on behalf of third parties in connection with, for example, an asset management mandate, to declare such holdings. It then examined whether this strict literal interpretation complies with the true meaning of the provision or whether there are substantial grounds for believing that the text does not fit in all respects to the perception the legislator wanted to give it. When performing its analysis, the Federal Supreme Court compared the text of other financial market regulation and found that the term "for its own account" is also used in other contexts, in particular to define the different categories of securities dealers subject to the SESTA. The securities dealer is deemed to act "for its own account" when it executes securities transactions in its own name without the order or instructions of others and when it bears the risk itself. By transposing this concept to the obligation to notify, the court held that someone who acquires or sells in its own name or in the name of a client, but who does not bear the economic risks must be considered *not* acting on its own behalf, but rather acts on behalf of the client. For asset managers, the Federal Supreme Court stated that it is the client who must therefore be regarded as the beneficial owner of such holdings and, thus, as the relevant holder for purposes of article 20 SESTA.

The Federal Supreme Court first referred to article 36 of the Swiss Constitution. This article provides that any restriction of a fundamental right must (i) have a legal basis, in case of serious restrictions in a law in the formal sense (and not only an ordinance), (ii) be justified by a public interest and (iii) be proportionate to the aim pursued. The Federal Supreme Court also referred to applicable literature and stated that requiring custodian banks and asset managers to report holdings belonging to their clients when they freely exercise the right to vote thereon, in some cases, may not improve transparency but instead create confusion due to a double notification concerning the same involvement. The Federal Supreme Court then compared article 20 SESTA and article 9(2) SESTO-FINMA with other provisions in Swiss law. After doing this, it found that neither article 31 SESTA, a provision providing for an obligation to notify in the context of takeover bids, nor article 9(3) SESTO-FINMA, a provision clarifying the meaning of indirect acquisition or sale, nor article 689(d) of the Swiss Code of Obligations contain any arguments or reasons to interpret article 20 SESTA in a way that nominees would generally be required to declare what they hold for the account of their clients. As a consequence, the Federal Supreme Court found, that article 20(1) SESTA is clear and that there are no compelling reasons to depart from the wording.

After concluding on this point and stating that there was no obligation for X. and its subsidiaries to report their own interests and the interests they hold on account of their clients on a consolidated basis, *a fortiori*, it said that such an obligation cannot be imposed on the shareholders of Class B, either. In the Federal Supreme Court's view, therefore, the question of building up did not arise in this context.

In its discussion, according to the author's reading, the Federal Supreme Court admitted, however, that there are still situations where it will be difficult to decide whether holdings of clients should be consolidated with the nominees' own holdings because of the extent of the discretion with respect to the exercise of voting rights and investment or divestment decisions and the nominees' factual control.

3) Discussion

One must positively note that the Federal Supreme Court questioned the legal basis of a general duty for all nominees to consolidate their own holdings with the holdings they hold for the account of several beneficial owners independent of each other and where they are entitled to exercise the voting rights. Since a violation of article 20 SESTA leads to administrative criminal proceedings, the standard applied for legal certainty and clarity of the formal law should indeed be high. But, as the Federal Supreme Court also admitted, they are still situations where the reasons underlying article 20 SESTA could call for a disclosure obligation of the nominee.

In order to swiftly address the argument of the Federal Supreme Court that article 9(2) SESTO-FINMA had no basis in article 20 SESTA, *i.e.* in the formal law, the Federal Council in the draft of the Financial Market Infrastructure Act (FMIA) launched for consultation on December 13, 2013, proposed to put the substance of article 9(2) SESTO-FINMA in the law itself. In the proposed draft article 110(2) of the FMIA, everyone who can freely exercise the voting rights with respect to shares has to take these shares into account when calculating his own position. The proposed wording would indeed focus on the relevant aspect underlying article 20 SESTA, namely who "controls" the voting rights with respect to the shares, independent of the legal status (ownership or beneficial ownership) with respect to them.

In practice, the question may now arise as to whether nominees who have previously based their disclosure practice on article 9(2) SESTO-FINMA will have to temporarily change their practice in light of the Federal Supreme Court's decision and will then have to come back to their current disclosure practice once the proposed article 110(2) FMIA is in effect. However, since the Federal Supreme Court admitted that there are situations where the extent of discretion with respect to the exercise of voting rights could qualify as an indirect acquisition in the meaning of article 9(3)(d) SESTO-FINMA, it is advisable that the nominees analyze the extent to which they are entitled to exercise voting rights and factually "control" the holding positions. In case of doubt, the nominees should request a recommendation from the DO as to the extent of their disclosure duties. However, in so far as the nominee legally or factually fully controls the shares, *e.g.* where the voting rights are freely exercised and where even all investment decisions are taken by the nominee, the Federal Supreme Court's decision does not change the current legal situation in the authors view, a view also implied in the commenting report of the Federal Council that was published simultaneously with the draft FMIA, and it will not change by implementation of the proposed article 110(2) FMIA.

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Alternatives and Trends on the Binding Vote on "Say on Pay"

Reference: CapLaw-2014-2

In CapLaw-2013-14 the editors of CapLaw commented on the draft ordinance (the Draft Ordinance) for the implementation of the constitutional initiative against excessive compensation (the Minder Initiative). Following the end of the consultation period for the Draft Ordinance, the final version of the "Ordinance against Excessive Compensation in Listed Companies" (*Verordnung gegen übermassige Vergütungen bei börsenkotierten Gesellschaften; VegüV*) (the Ordinance) was published on 20 November 2013 and entered into force on 1 January 2014. This article comments on one of the key aspects of the new rules: the "say on pay", i.e. the shareholders' vote on executive compensation.

By Daniel Raun/Thomas Reutter

1) Binding vote on executive compensation

One of the centerpieces of the Minder Initiative is the introduction of "say on pay" for the shareholders of Swiss listed companies. The compensation for the board of directors, the executive management and the advisory board, if applicable, will in the future be subject to a binding vote by the shareholders at the annual general meeting. Companies that are subject to the new provisions therefore face the task of conforming, among others, their articles of incorporation to the new statutory regime.

2) Transitional period

The Ordinance sets out transitional periods for the implementation of the new restrictions, including for any amendments of the articles of incorporation, which must be resolved at the 2015 annual general meeting at the latest. However, as was already pointed out in CapLaw-2013-14, p. 4, it may be prudent for companies not to wait until 2015 but to propose such amendments to the shareholders at this year's annual general meeting already. Given that the amounts of compensation will have to be put to the shareholders' vote for the first time in 2015, the revision of the articles of incorporation in 2014 would provide certainty as to the applicable voting procedure (see 3) below). Furthermore, adapting the articles of incorporation ahead of 2015 has the advantage that any further changes, which may become necessary as a result of the shareholders rejecting some of the proposals in 2014 or otherwise, could be put on the agenda of the 2015 annual general meeting. It appears that indeed a majority of the companies share this view and have decided to revise their articles of incorporation in 2014 for these reasons.

3) Voting mechanism

a) No default voting mechanism

One of the most notable differences of the Ordinance compared to the Draft Ordinance concerns the vote on executive compensation. In the absence of any provisions in the articles of incorporation, under the Draft Ordinance a prospective vote on each of the board of directors' and the executive management's (and, if applicable, the advisory board's) fixed compensation for the period until the next annual shareholders' meeting and a retrospective vote on the variable compensation for the previous financial year would have applied. While the core principles established by the Draft Ordinance in respect of the shareholders' "say on pay" remained unchanged, the Ordinance does no longer provide a default voting mechanism. Consequently, companies will in any case have to specify in their articles of incorporation the procedure of the vote on executive compensation. Failure to do so could lead to criminal liability of the members of the board of directors under the criminal sanctions of the Ordinance.

b) Statutory principles and available voting mechanisms

In specifying the procedure for the vote on the executive compensation, companies need to observe certain standards set out in article 18 (3) of the Ordinance. First, the executive compensation must be put to the shareholders' vote annually. Second, the compensation must be approved separately for the board of directors, the executive management and, if applicable, the advisory board (but in each case only on an aggregated basis). Third, the vote must be binding (though companies may on a voluntary basis provide for a consultative vote which is in addition to the votes mandated by the Ordinance; see c) below).

There are two basic concepts how executive compensation can be put to vote. A ***retrospective vote*** allows shareholders to approve the remuneration actually awarded. By contrast, in a ***prospective vote*** shareholders set maximum amounts ("caps"; "budget") for future periods. Additionally, the articles of incorporation will have to specify for which reference period the compensation shall be approved. While a retrospective vote with reference to a period other than the preceding business year would seem unusual, there are a number of conceivable options if a company opts for prospective voting. The three alternatives most commonly discussed are the period from one annual general meeting to the next, the current business year or the next business year (though other reference periods are likewise permissible, e.g. midyear to midyear). Companies are free to use different reference periods for the fixed compensation and the variable compensation and for the board of directors and the executive management (and the advisory board), respectively. The articles of incorporation may further provide for the approval by the shareholders of one amount comprising both the fixed and variable compensation if the reference periods are the same (the vote on only one amount for incongruent periods seems impracticable), or of two separate amounts.

c) Trends and guidance

As mentioned in 2) above, most companies intend to propose to their shareholders the revision of the articles of association at this year's annual general meeting. In view thereof, fund managers and independent proxy advisors such as zCapital, SWIPRA and, most recently, Ethos have issued guidelines which provide guidance as to which voting mechanisms would be deemed to fulfil the key criteria set by such organizations. Based on these criteria, a combination of a prospective vote on fixed compensation with a retrospective vote on variable compensation is generally approved of. However, SWIPRA has pointed out in its position paper that a retrospective vote on remuneration paid under a long term incentive program (LTIP) would not take account of the fact that amounts paid under LTIPs do not aim to compensate for past performance but to incentivize future performance. Consequently, SWIPRA considers a mechanism which provides for a retrospective vote only with respect to short term bonuses more appropriate. Ethos takes the same view but for a different reason: it argues that the criteria for short term (annual) bonuses often constitute sensitive information which cannot be made public in advance to the extent that would be necessary to achieve the degree of transparency required for a prospective vote. In any case, Ethos favors a vote that separates fixed from variable compensation.

As an alternative to having the shareholders approve the variable compensation (or parts thereof) in a binding retrospective vote, companies may choose to combine a prospective (binding) vote on the entire remuneration, both fixed and variable, with a retrospective consultative (i.e. non-binding) vote on the compensation report (*Vergütungsbericht*). Both SWIPRA and zCapital accept that there may be legitimate reasons why a retrospective vote could be deemed inappropriate and that a consultative vote, though not binding, may nonetheless be an effective means for shareholders to express their views.

Even though many companies (and their legal advisors) have not yet concluded the process of drafting the necessary amendments to the articles of incorporation which they intend to propose to the shareholders, it appears that a majority will opt for the prospective approach. In light of the views described above, it is expected that in most companies' annual general meetings there will also be a consultative vote on the compensation report (which may not be reflected in the articles of association). Further, there is also a preference that the prospective vote be with reference to the following business year. There seem to be relatively few companies in favor of a vote in relation to the current business year or the period between two annual general meetings (or, in exceptional cases, yet another reference period). Finally, current trends suggest that one vote for both the fixed and variable compensation will be the predominant choice, though by comparison to the aforementioned decisions it is arguably of much less consequence whether one vote or separate votes are held.

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Prohibited Compensation Payments under the Minder Ordinance (VegüV)

Reference: CapLaw-2014-3

The ordinance implementing the Minder Initiative also introduces new criminal offenses in connection with certain specific and now illicit compensation payments to certain senior persons associated with a listed company. The affected compensation payments encompass: severance payments, payments in advance and commissions for certain M&A transactions. This article endeavors to shed more light on scope and consequences of such prohibited payments.

By Thomas Reutter/Daniel Raun

1) Introduction

On 3 March 2013 the Swiss people approved by referendum a popular initiative imposing restrictions on executive compensation in listed companies first promoted by Swiss entrepreneur Thomas Minder (the so called Minder Initiative). The constitutional amendment approved in this referendum was transposed by the Swiss government into a more detailed and more specific implementing legislation: The Ordinance against excessive compensation in listed companies (*Verordnung gegen übermässige Vergütungen in börsenkotierten Gesellschaften; Ordonnance contre les rémunerations abusives dans les sociétés anonymes cotées en bourse*; hereafter the Ordinance or ExCompO). Its main objective is to empower shareholders as principals vis-à-vis the executive management as their agents in corporate governance questions and in particular in say on pay.

ExCompO also introduces new criminal offenses in connection with certain specific and now illicit compensation payments to certain senior persons associated with a listed company (article 24 (1) ExCompO). The affected compensation payments encompass: severance payments, payments in advance and commissions for certain M&A transactions (together the Prohibited Compensation Payments). Criminal offenses may lead to harsh sanctions of prison sentences of up to three years and fines.

It is important to clarify the scope of these Prohibited Compensation Payments (see below), but some general considerations on the nature of the new criminal provisions will have to be made first.

2) The new offenses in general

The criminal offense sanctioned by article 24 (1) ExCompO involves Prohibited Compensation Payments by or to certain senior persons. Although these senior persons include members of the board of directors, members of the group's executive management and members of its advisory council (*Beirat*), if any, (together Senior Persons) it will be the members of the group's executive management who will for all practical purposes be liable for receiving Prohibited Compensation Payments and the members of the board of directors who will be liable for granting Prohibited Compensation Payments. Other persons that may be involved, such as assistants to executive management members, persons in the HR department or persons involved in the actual money transfer (e.g. at a bank), may not be punishable.

The punishable act is the awarding or granting (*ausrichtet; octroie*) or the receiving (*bezieht; reçoie*) of Prohibited Compensation Payments. Even though the German word "*ausrichten*" could indicate a requirement to effect the actual money transfer in order to commit the offense, the French and also the Italian version (*corrisponde*) lead to a different and more meaningful interpretation in line with a purposive approach: A Senior Person will hardly ever be involved in the actual transfer of the money; hence the award in the sense of creating or conferring a legal entitlement must be relevant. The act so defined may include the entering into a contract or an affirmative vote in a resolution to grant a Prohibited Compensation Payment to a Senior Person.

In order to be punishable, a Senior Person must have committed the offense knowingly (*wider besseres Wissen; sciémment*). This knowledge must involve knowledge about the legal qualification of the relevant executive compensation as a Prohibited Compensation Payment, e.g. as a severance payment. In particular, the German version of the Ordinance makes it clear that a mere negligent or reckless compensation payment which turns out to be qualified as a Prohibited Compensation Payment, a fact as to which the involved parties have no affirmative knowledge, may not lead to criminal charges. This also means that the board of directors and the executive management may avoid criminal liability by seeking a prior legal expert opinion on the qualification of a certain payment. It would be sufficient for such opinion to reasonably state that it is more likely than not that the compensation payment in question does not qualify as a Prohibited Compensation Payment. Such a conclusion would in our view provide a valid defense showing that the required state of mind for a criminal charge (*subjektiver Tatbestand*) was not present.

The provision aims to prohibit certain payments to Senior Persons considered abusive in order to safeguard corporate assets for the benefit of the shareholders. Board members and executive management are agents or fiduciaries of shareholders and should abstain from what is viewed as "embezzlement"-like conduct. Therefore, a potential damage and loss of corporate assets may only occur once the consideration is transferred to a Senior Person and the criminal offense is only completed when the asset transfer has occurred at least in part. Prior to such transfer, a Senior Person may only be charged with attempted payment of Prohibited Compensation Payments.

Only members of the board of directors or of the executive management (or the advisory council, if any) may be charged with the offense of paying or receiving Prohibited Compensation Payments. However, does this mean that other corporate officers or employees will remain completely outside any criminal risk? The Penal Code (PC) also sanctions aiding and abetting for so-called special offenses (*Sonderdelikte*) whose principal perpetrator by law may come only from a group of people meeting certain criteria such as Senior Persons in the present case (article 26 PC). Consequently, one may argue that inhouse legal counsel, people working in HR or assistants of Senior Persons, acting knowingly, may be charged as accessory in the crime of Prohibited Compensation Payments. However, in more typical settings, people that may take part in any offense of Prohibited Compensation Payments are almost exclusively in positions inferior to Senior Persons and therefore must generally follow their instructions. Also, it will likely in many cases not be immediately obvious whether a payment constitutes a Prohibited Compensation Payment nor would the unfairness or inappropriateness of conduct related to such payment be conspicuous. It is therefore likely that aides and abettors would not usually have the intent of paying Prohibited Compensation Payments and that they would (and should) not be criminally liable.

The nature of the consideration must obviously be an "asset" or a "monetary benefit", but its nature (cash, shares or other forms of consideration) is irrelevant.

3) Prohibited Payments

a) Severance Payments

Severance Payments are inadmissible and may even result in criminal liability. Despite this harsh consequence, the term "severance payments" (*Abgängsentschädigungen; indemnités de depart*) is not defined in the Ordinance or anywhere else. The wording of article 20 (1) ExCompO at least clarifies the obvious: Payments payable as a result of applicable legal provisions upon termination of employment remain permitted. Also, compensation payments until the termination of the contractual relationship with the Senior Person are not prohibited. However, such term is limited by article 12 (1) (2) ExCompO to one year meaning that notice periods (and, by the same token, fixed term employment contracts) may not last for more than one year. But what kind of payments are intended to be prohibited by the Ordinance?

One of the main goals of the Minder Initiative was to abolish "golden parachutes" or "golden handshakes" for Senior Persons that had been observed in practice in particular in connection with change of control transactions. The main characteristic of these payments – irrespective of whether stipulated in the original employment or mandate terms or in any subsequent amendment – is that they are made *ex gratia*, *i.e.* without any specific consideration or performance given by the affected officer. The goal of the new legislation seems to have been to eliminate these *ex gratia* payments. However, there are a number of ways in which these unwelcome payments can be replicated or repackaged and any prohibition is therefore prone to abuse. Considering this, the legislature explicitly put overly lengthy notice periods or fixed contractual terms (in excess of one year) on the same footing as ex gratia payments in connection with termination.

Having clarified the background, the question remains which of the many manners of compensation have to be put on a "black list" because they are akin to prohibited ex gratia payments and which payments should be put on a "white list" because they lack this criterion (see also Ralph Malacrida/Till Spillmann, Corporate Governance im Interregnum, GeskR 2013, p. 485 et seqq., for an overview in German). The "white list" includes payments that are widely believed not to constitute Prohibited Compensation Payments. These include:

- contractually agreed compensation payments that accrue in the period to termination capped at one year's compensation payment;

– compensation for competition bans post termination to the extent not abusive, which will likely be the case if they do not exceed market benchmarks;

– accelerated vesting of equity securities under participation plans: These compensation elements have been awarded on a deferred and often also on a conditional basis. "Whitelisting" of such compensation consideration or grant is justified by commentators as being in the interest of the corporation and because past performance is usually honored by such acceleration (see Malacrida/Spillmann – Corporate Governance im Interregnum, GesKR 2013, p. 497). We believe, however, that the main reason for whitelisting is the fact that the deferred awards would have accrued to their beneficiary with lapse of time in any event. This evidences that such payments are not akin to ex gratia payments in connection with a termination. Acceleration clauses should merely be confined to conferring entitlements earlier in time; if they confer more in amount they should be put at least on a "grey list".

The black list includes:

– Ex gratia payments in connection with termination of office such as golden parachutes and the like whether or not pre-agreed or only agreed upon termination;

– Notice periods or terms of employment or office of more than one year or an extension of any pre-agreed period to a term of more than one year.

The "grey list" includes compensation payments whose admissibility seems unclear to us. Given this uncertainty, it seems more likely than not that such payments would not result in criminal liability. Nevertheless, a cautious approach would clearly command to refrain from such payments.

– Salary increase for the remainder of term of office: An amendment to the terms of employment of a Senior Person having submitted a notice of termination can usually only be justified if the respective officer withdraws his or her resignation. If this is not the case, it seems hard to argue that a salary increase is not a disguised severance payment even though such increase may be justified in exceptional cases.

– Extension of the notice period to up to one year: The same analysis as above applies in our view.

– Compensation payments in termination agreements: It may not be justified to "whitelist" such compensation payments simply because they are in an arm's length agreement. Such payments may constitute ex gratia payments if no adequate performance or waiver of rights by the employee officer is related thereto. However, in light of the severe consequences and *minima non curat praetor*, criminal authorities should only interfere in blatant cases.

b) Payments in advance

Article 20 (2) prohibits "payments in advance" (*Vergütungen, die im Voraus ausgerichtet werden*). The commentary to the draft bill dated 14 June 2013 (Commentary) sheds some light on this rather cryptic term. The intention seems to be to prohibit payments for services that have not yet been performed. Compensation of Senior Persons must therefore be made in arrears according to the intention of the lawmaker (*"erst nach erbrachter Leistung ausrichten…"*; Commentary, 3.9.3). By contrast, sign-on bonuses (*Antrittsprämien*), understood to be a compensation for losses suffered by a newly hired Senior Person at its former position (e.g. forfeiture of options etc.; see additional commentary to the Ordinance dated 8 October 2013 (Additional Commentary)), should remain possible. In light of such scope, it seems to be misleading to refer to a "bonus" or "premium". Rather, the Additional Commentary seems to just allow compensation for losses as opposed to a monetary incentive payment to accept a new position as a Senior Person in a Swiss listed corporate. Contracts stipulating such payments should therefore be carefully crafted and genuine monetary incentives beyond losses suffered, although not clearly prohibited in our view, should be avoided.

In addition, the term "payments in advance" is dangerously unspecific for a criminal liability provision. A payment of a salary on the 21st of a calendar month would still constitute a payment in advance for part of the services in such calendar month. By the same token, an accelerated vesting of options prior to the stated original time of vesting could be viewed as payment in advance.

We note that the intention of the promoters of the initiative was to limit the prohibition of payments in advance to new hires (*Stellenantritt*). The commentary to the initiative explicitly states: "..prior to starting their term of office.." (*"bevor sie ihre Stelle überhaupt angetreten haben"*). It seems unjustified to go even beyond the intention of the promoters in this respect. Also, the principle of legality in criminal proceedings (*Legalitätsprinzip; nulla poena sine lege*) mandates restraint when it comes to a wide interpretation of a rather vague criminal provision. Payments in advance during the term of a Senior Person's office may be reclaimed under private law if they relate to periods for which no services have been performed as a result of early termination. In light of the foregoing, we take the view that the term "payment in advance" is to be interpreted in the narrow way intended by the promoters of the initiative and hence be restricted to payments to newly hired Senior Persons prior to them starting their new position. We note, however, that the legislator of the Ordinance seems to be willing to go beyond this view creating unnecessary legal uncertainty.

c) Commissions for certain M&A transactions

The Ordinance also prohibits certain commissions to Senior Persons in connection with M&A transactions by the listed parent company or its subsidiaries (article 20 (3) Ex-

CompO; *Provisionen für die Übernahme oder Übertragung von Unternehmen*). According to the Commentary a commission is to be interpreted in line with employment law (article 322b of the Code of Obligations) meaning that a commission is the entitlement of the employee to a share of the value (however defined) of a contract entered into by the employer usually expressed as a percentage (see Commentary, 3.9.4). One should note that the term mergers and acquisitions is a bit too narrow as the provision in question covers all sorts of share or asset transfers involving businesses irrespective of their legal form.

The Additional Commentary states that only commissions for M&A intra-group transactions (*konzernintern*) would be affected and hence prohibited. The term "intra-group" seems to be a misnomer. It implies that both transferor and transferee are entities of the same group. This is not the case for the M&A transaction commissions made illegal by article 20 (3) ExCompO. The wording of the provision suggests that it is applicable if either the transferor or the transferee are group companies of the Swiss listed parent. The addition of "…by the company or an undertaking controlled by the company…" also seems to exclude transactions involving a change of ownership of the parent itself. This is probably what was meant by the Commentary when it stated that the criminal provision only encapsulates intra-group transactions, i.e. to the exclusion of transactions in shareholdings of the group's parent. Only for the former a risk of commissions that are economically not justified can be identified according to the Commentary (Commentary, 2.9). This in turn would indicate that the lawmaker was of the view that the interests of shareholders and Senior Persons are aligned when it comes to a change of control of the parent, but are not similarly aligned if a subsidiary is sold. It would seem, however, that alignment of interests is rather a matter of defining the trigger for the commission and less so a question of the level of any given M&A activity in a group of companies. The purpose of differentiating between these two types of transactions remains therefore somewhat elusive. Nevertheless, in light of the principle of legality requiring an unambiguous statutory basis for criminal offenses, commissions for M&A transactions in the listed parent company cannot entail criminal charges in our view.

In any event, payments to Senior Persons for additional work performed in connection with M&A transactions remain possible. It also remains possible, in our view, to identify specified M&A transactions as one or more targets within a variable compensation scheme.

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FINMA favours Single Point of Entry Bail-in as Optimal Resolution Strategy

Reference: CapLaw-2014-4

In August 2013, the Swiss Financial Market Supervisory Authority FINMA issued a position paper on the resolution of globally systemically important banks. With its new policy in relation to the importance of a bail-in strategy for large financial institutions FINMA joined regulators in the United States, Europe and elsewhere to focus on a bail-in of troubled financial institutions rather than a bail-out by tax payers or a liquidation.

By René Bösch

Following the global financial crisis the G-20 leaders endorsed at the Pittsburgh Summit in 2009 the objective of strenghtening the financal regulatory system and, *inter alia*, ending "too big to fail". National legislators and regulators moved to transform that objective into national law, and the Financial Stability Board (FSB) established key principles for the way how this objective shall be achieved. Various techniques and options for resolving large, internationally active financial institutions were discussed, including the forced sale of business/purchase of all or the majority of the business of a failing institution, bail-in of subordinated or senior debt, liquidation or state aid.

In an article published in the Economist in January 2010, Wilson Ervin and Paul Calello promoted a new, prefered process for resolving failing banks: the "bail-in" by way of converting stakeholders' claims into equity, making them new owners of the bank. Ervin and Calello maintained that a bail-in could have allowed Lehman to continue operating and forestall much of the investor panic that froze markets and deepened the recession. This bail-in technique received quick and widespread interest, in particular in the United States. The Orderly Liquidation Authority section in the Dodd-Frank Act of 2010 provided a first, detailed framework for a bail-in within resolution. The EU in the meantime also accepted this technique as one of the resolution options within the framework of the Bank Recovery and Resolution Directive.

In its work towards the "Too Big to Fail"-Amendment to the Banking Act of 2012, the Swiss legislator, based on recommendations of an expert group, held that failing systemically relevant banks had to provide for an emergency plan on the basis of which they had to assure that in the case of threatening insolvency the systemically relevant functions should be transferred to a new legal owner. This "bridge bank concept" formed the cornerstone of Switzerland's (initial) answer to the too-big-to-fail conundrum. While the bail-in option was not substantively considered as an alternative, the new TBTF legislation did not close the door to it. Rather, by way of a total overhaul of the Bank Insolvency Ordinance of FINMA that became effective in late 2012, bail-in received acceptance as a viable resolution technique for Swiss banks.

Guided by the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions of October 2011 and its discussions with other regulators, FINMA developed a resolution strategy for Switzerland's global systemically important banks (G-SIBs). Giving regard to the various issues in the cross-border resolution of internationally operating financial institutions, in the Summer of 2013 FINMA arrived at the conclusion that its preferred resolution strategy for these financial groups consists of a resolution led centrally by the home supervisory and resolution authority, focusing on the top-level group company. This strategy is generally referred to as the "Single Point of Entry" (SPE) approach, in contrast to the "Multiple Point of Entry" (MPE) approach where several entities within a group shall be subject to bail-in. Creditors of the top-level company shall bear a share in the losses of the bank, allowing the entire group to be recapitalised. In a position paper published in early August 2013 FINMA has presented the reasoning for arriving at this conclusion.

First, FINMA considers that while the bridge bank concept may initially have been at the core of Switzerland's considerations of how to address the too big to fail conundrum, international trends moved into the direction of bail-in as a preferred choice for the resolution of large international banks. SPE bail-in had been promoted as a preferred choice from a regulator's perspective in a joint paper published in 2012 by the Federal Deposit Insurance Corporation and the Bank of England. Having received the legal basis for applying the bail-in technique to failing Swiss banks, FINMA considered and agreed that this technique may in fact be superior to the bridge bank concept. Weighing all pros and cons FINMA found that the SPE bail-in is "the best solution for the current group structure and the global business models of Switzerland's two globally systemically important banks".

FINMA is convinced that it can observe the three fundamental principles governing bank resolution proceedings when applying a bail-in: the hierarchy of creditors, the principle of equal treatment of creditors of the same class, and the "no-creditor-worse-off" test. However, FINMA equally concedes that there is one decisive condition for an SPE bail-in: a sufficient quantity of liabilities available for bail-in. But FINMA also expresses some concerns: for tax reasons a large proportion of the debt instruments of the Swiss G-SIBs has been issued out of foreign branches of the Swiss bank, and most of these instruments are governed by non-Swiss law. While FINMA asserts resolution authority over non-Swiss branches of Swiss banks, it concedes that local regulators may nevertheless be authorized to take possession over these branches by statute. Therefore FINMA identified execution risks of an SPE bail-in. In its view these execution risks could be addressed by several measures: host authorities should be encouraged to support a FINMA bail-in over a branch through which the bank issued its debt; cooperation agreements with host authorities should be executed, and "bail-in clauses" as well as Swiss law and jurisdiction should be introduced in the debt instruments.

With its reference to the "bail-in clauses" FINMA may have been refering for instance to the issuance by Barclays Bank PLC of $ 1bn Contingent Capital Notes in April 2013, the terms of which contain an agreement of the holder of these notes that it be bound to any UK bail-in power by the relevant UK resolution authority that may result in the cancellation of all or a portion of the notes. It will be interesting to see whether similar provisions will find their way into future debt issuances of Swiss banks.

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Proposed Regulatory Framework for Financial Products in Switzerland

Reference: CapLaw-2014-5

Two new pillars of financial markets regulation are currently being elaborated in Switzerland. The proposed laws will have a strong impact on banks, securities dealers, issuers and distributors of financial products, fund management companies, external asset managers, individual client advisors, and trading venues with respect to the legal structuring, distribution, trading, and clearing and settlement of financial products. This article provides a brief overview on the expected key points of the new laws and sets out their potential effects on financial product providers in Switzerland.

By Luca Bianchi

1) Introduction

The collapse of Lehman Brothers on 15 September 2008 and the following financial crisis (including the Madoff Scandal) have led to various global regulatory changes. In this context, the legislation in the European Union (EU) has (and continues to have) a strong impact on Swiss regulatory developments. Consequently, the changes that are in the process of being introduced in the EU by the Markets in Financial Instruments Directive (MIFID II) and the European Market Infrastructure Regulation (EMIR) are similarly being implemented in Switzerland through two new pillars of financial markets regulation. The proposed Financial Services Act (FFSA) is expected to regulate the creation of financial products and related services (including distribution). Furthermore, the proposed Financial Market Infrastructure Act (FMIA) is expected to contain rules on trading venues, OTC-derivatives clearing and settlement, and the general transparency of derivative markets. Both laws aim to install consistent rules (*i.e.* a level playing field) for all financial product providers and other market participants.

2) Financial Services Act (FFSA)

a) Scope of the new Law

The new law targets a cross-sector regulation of financial products and services, mandates extended investor protection at the point of sale, and enhances the supervision of certain market participants (cp. Federal Department of Finance (FDF), Financial Services Act (FFSA) — Key thrusts of potential regulation, 18 February 2013, 1 et seq.).

b) Key Points

The FFSA is expected to cover the following key points:

i) Prospectus duty for all securities

All securities offerings that are issued in or from Switzerland will be subject to the duty to publish a prospectus. The new law will likely provide for exceptions in connection with securities offerings with a minimum denomination of CHF 100,000 which are addressed to a restricted circle of investors and certain other specific situations. The structuring and content of the prospectus will also be regulated. In addition, a legal basis for a cross-product prospectus liability may be implemented to the new law.

ii) Key Investor Information Document (KIID)

For all complex financial products a KIID must be published and offered to retail clients free of charge before the subscription/purchase of the product. Complex financial products will presumably comprise standard or tailor-made combined products that consist of different parts (*i.e.* structured products, fund shares/units, certain insurance investment products, and bonds with particularly complex features). The KIID will be required to contain a simplified product description and risk disclosure to facilitate the comparison and understanding of different products for retail investors.

iii) Duties at the point of sale

Regulated and unregulated financial service providers will be subject to a cross-sector code of conduct containing minimum requirements applicable for all market participants. In particular, distributors of financial products may be obliged to perform suitability checks and fulfill documentation and information duties regarding characteristics, costs (including a disclosure of third-parties remunerations) and risks of financial products.

iv) Client segmentation

Market participants will be required to inform clients as to which client segment they are allocated (qualified investors vs. non-qualified investors). Under certain circumstances, non-qualified investors will have the possibility to opt-in to the qualified investor status based on their know-how, professional experience, and/or a minimum wealth requirement in order to benefit from a more sophisticated investment universe. On the other hand, some qualified investors will likely have the option to opt-out of the qualified investor status in order to benefit from investor protection.

v) Regulation of external asset managers

External asset managers will potentially be subject to more intense rules of conduct and prudential supervision by either FINMA or self regulatory organizations (i.e. SROs).

vi) Licensing requirements for individual client advisors

Individual client advisors which perform the distribution of financial products will most likely need to publicly register as licensed client advisors. The existing licensing requirements for institutions acting as distributors of collective investment schemes will, potentially, be abolished and replaced by the licensing requirements for individual client advisors.

vii) Regulation of cross-border activities into Switzerland

It is expected that foreign financial services providers will have to comply with the same code of conduct as Swiss providers for their cross-border activities (including the requirement to perform suitability checks). Thus, they will have to inform their Swiss-based clients (and their clients that are covered from Switzerland) about themselves, their services, and their products. Furthermore, foreign financial services providers will either have to register or, conceivably, establish a branch in Switzerland. However, it is possible that equivalent home country rules will be sufficient in certain cases.

The above key points are based on current expectations and may be subject to amendments during the legislative process.

c) The Road to FFSA

The following timetable represents an indicative schedule for the implementation of the FFSA. Financial product providers should be aware that the legislative process may differ from the dates set out below.

Timetable regarding the Entering into Effect of the FFSA										
2013	2014				2015				2016	2017
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1-4	Q1
Hearing and examination phase (*Vernehmlassung*)			Preparation Message of the Federal Council (*Botschaft*)	Submission of Message by the Federal Council (*Botschaft*)	Consideration 1 (National Council or Council of State)	-	Consideration 2 (Council of State or National Council)	Resolution of differences (*Differenzbereinigungsverfahren*)	Entering into effect of the FFSA	

d) Possible Effects on Financial Product Providers

The FFSA will have a strong impact on financial product providers with respect to the legal structuring of financial products. Primarily, the required documentation for new products will be affected (and potentially more cumbersome). Furthermore, the new law may have an impact on existing product documentation, distribution agreements, internal guidelines, and the setup of the sales process (including the education of the sales force as well as the required registration of all individual client advisors). In conclusion, the new law will have massive consequences for the production and the distribution of financial products.

3) Financial Market Infrastructure Act (FMIA)

a) Scope of the new Law

The purpose of the FMIA is to enhance the functioning, the stability, and the transparency of financial markets as well as the protection and equal treatment of investors (cp. Preliminary Draft of the FMIA (PD-FMIA) and Federal Department of Finance (FDF), Financial Market Infrastructure Act – Preliminary Draft to the Consultation Proposal of 29 November 2013, 1 et. seq.).

b) Key Points

The FMIA will set out rules on the following key aspects:

i) Regulation of trading venues

Licensing duties for stock exchanges, multilateral trading facilities (MTFs) and organized trading facilities (OTFs) that allow, and in some cases restrict, multilateral trading will be implemented. In principle, the same general authorization requirements will apply for all trading venues (in particular, concerning organization standards, proper business conduct requirement, outsourcing, and capital requirements). However, the principle of self-regulation will continue to apply. Non-Swiss trading venues will be obliged to obtain recognition by FINMA before they grant access to Swiss participants that are regulated by FINMA.

ii) Regulation of post-trading infrastructure

Central counterparties, central custodians, transaction registers, and, potentially, payment systems, will be subject to licensing requirements. Respective authorization requirements will be included to the new law. In addition, duties and provisions concerning the handling of insolvencies of systemically relevant post-trading infrastructures will be installed.

iii) Transparency

Trading transparency and market monitoring will be enhanced. In particular, a transaction register will be implemented.

iv) Derivatives Trading

The new law aims for an implementation of clearing, notification, and risk minimizing duties for all derivatives (not only OTC-derivatives). It will include the duty for some counterparties to settle trades over a central counterparty (CCP). In addition, some counterparties will be obliged to trade all derivatives on a FINMA-approved or recognized trading platform or venue. FINMA will have to specify which derivatives will be subject to this rule based on the following criteria: standardization, liquidity, trading volume, price transparency, and counterparty risk. Furthermore, counterparties of derivatives transactions will be obliged to notify a FINMA-approved or recognized transaction register with respect to their derivatives transactions.

v) Rules on Market Conduct

The current rules on market conduct will be subject to the new law. The provisions regarding the disclosure of share holdings, public offers, insider trading, and market manipulation will be transferred to the FMIA.

vi) Penal provisions

The criminal sanctions concerning breaches of the professional secrecy, documentation or notification duties, duties related to derivatives trading, disclosure duties, public offer related duties, as well as insider trading, and price manipulation will be inserted to the FMIA. Breaches of these provisions may lead to major penal sanctions.

The key points of the law outlined above are based on currently available public information. The actual content of the law may be subject to amendments in the course of the legislative process.

c) The Road to FMIA

The following timetable represents an indicative schedule for the implementation of the FMIA. However, the legislative process may differ from this indicative schedule and readers should be aware that the below stated dates may not be accurate.

Timetable regarding the Entering into Effect of the FMIA								
2013	2014				2015			
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Hearing and examination phase (*Vernehmlassung*)	Preparation Message of the Federal Council (*Botschaft*)	Submission of Message by the Federal Council (*Botschaft*)	Consideration 1 (National Council or Council of State)	Consideration 2 (Council of State or National Council)	Resolution of differences (*Differenzbereinigungsverfahren*)	Entering into effect of the FMIA		

d) Possible Effects on Financial Product Providers

The FMIA will affect the clearing and settlement of OTC-derivatives, including structured products, either directly and/or with respect to hedging transactions. In consequence, adjustments to operative processes, updates of related agreements as well as changes in the product documentation will be required. Therefore, all financial product providers should continue to monitor the potential impact of the new legislation on their business models and, eventually, adapt to the new rules. Due to the major penal sanctions regarding breaches of some provisions of the FMIA, compliance with the respective provisions will become very important.

4) Conclusion

The entering into effect of the FFSA and the FMIA will initiate a new era of financial product regulation in Switzerland. Once the drafts of the new laws are published, market participants need to assess whether and to what extent, their business will be affected. Subsequently, market participants targeted by the new laws will need to begin preparations for the necessary adjustments to their business. CapLaw will continue to report on important questions and developments on the road to the FFSA/FMIA.

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Draft Bill Financial Market Infrastructure Act: Initial Thoughts on the New Rules for OTC-Derivatives

Reference: CapLaw-2014-6

On 13 December 2013, the Federal Council launched the consultation on the Financial Market Infrastructure Act (FMIA). In line with market developments and international requirements, FMIA adjusts the regulation of financial market infrastructure and introduces new rules on derivatives trading. This article, which continues a series of articles on FMIA, focuses on the new rules for over-the-counter (OTC) derivatives.

By Stefan Sulzer/Petra Ginter

1) Introduction

The financial crisis has brought derivatives to the forefront of regulatory attention. In 2009, the G-20 leaders agreed in Pittsburgh that all standardized over-the-counter (OTC) derivative contracts should be traded on exchanges, cleared through central counterparties, and registered with trade repositories by the end of 2012. In the EU (European Market Infrastructure Regulation – EMIR) and in the US (Dodd-Frank Act), legislation has been passed in 2010 and 2012, respectively, to regulate OTC derivatives (see CapLaw-2013-13, CapLaw-2012-54, CapLaw-2011-24, CapLaw-2010-47, and CapLaw-2010-34).

The existing Swiss regulation of financial market infrastructure has not kept up with the developments in the global financial markets and does not satisfy the new international standards and commitments. On 29 August 2012, the Federal Council announced that new legislation is required to ensure competitiveness of the Swiss financial market and to strengthen financial stability. Thereby, the G-20 commitments and the Financial Stability Board recommendations on OTC derivatives trading should be implemented as fully as possible. On 13 December 2013, the Federal Council launched the consultation on the FMIA and invited interested parties to provide comments on the draft bill (the draft bill is available under http://www.news.admin.ch/NSBSubscriber/message/attachments/33179.pdf). The consultation will run until 31 March 2014.

2) Overview of the New Rules

The new rules on OTC derivatives are contained in articles 87 et seq. FMIA. The rules are modeled after the analogous regulation in the EU (EMIR) as derivatives trading in Switzerland is mainly cross-border trading and predominantly with EU-counterparties.

The new rules are applicable to all OTC derivatives, irrespective of the documentation used (*e.g.*, ISDA Master Agreement or Swiss Master Agreement published by the Swiss Bankers' Association). Repo transactions and securities lending are, however, not considered derivatives in the meaning of FMIA.

The new rules introduce the following four basic pillars: (i) obligation to clear standardized derivatives trades through central counterparties, (ii) obligation to report derivatives trades to trade repositories, (iii) risk mitigation obligations, and (iv) obligation to trade standardized derivatives on trading platforms. According to the draft bill, the duty to trade derivatives on trading platforms will not yet be mandatory with the entry into force of FMIA. Rather, such duty shall only become mandatory once international developments indicate the requirement of such duty.

3) Specific Rules on Derivatives

a) Scope of Application (Articles 87 and 88 FMIA)

The new rules on derivatives apply to "Financial" as well as "Non-Financial Counterparties" (as defined in the FMIA) that are incorporated in Switzerland. Financial Counterparties are banks, securities dealers, primary insurers, reinsurers, holding companies of a financial or insurance group or conglomerate, fund management companies, SICAVs, limited liability companies for collective investments schemes, SICAFs and asset managers for collective investment schemes. A Non-Financial Counterparty is a legal entity that is not a Financial Counterparty. The Federal Council may declare that the new rules also apply to Swiss branches of foreign financial market participants in case they are not subject to equivalent foreign regulations.

The new rules do not apply to the Swiss Federation, Cantons and political communities, the Swiss National Bank (SNB) or the Bank for International Settlement (BIS).

b) Clearing Through a Central Counterparty (Articles 89 et seq. FMIA)

Article 89 FMIA introduces for Financial as well as Non-Financial Counterparties the obligation to clear all standardized derivatives trades through FINMA approved or recognized central counterparties (CCPs). The clearing obligation also applies in case a foreign counterparty of a Swiss counterparty that is required to clear through a CCP would be obliged to clear through a CCP if it had its domicile in Switzerland.

It is up to FINMA to define which derivatives trades are standardized in the sense of FMIA, and up to the Federal Council to determine the applicable thresholds as well as the calculation method for each category of derivative.

Exceptions to the clearing obligation apply to certain intra group trades, to "Small Non-Financial Counterparties" (article 90 FMIA) as well as to "Small Financial Counterparties" (article 91 FMIA).

c) Reporting to Trade Repositories (Articles 96 et seq. FMIA)

Financial and Non-Financial Counterparties as well as CCPs must report certain information regarding derivatives trades to a FINMA approved or recognized trade repository (TR). The reporting obligation applies to all OTC derivatives trades (not only to standardized derivatives transactions). It may be delegated to a third party, such as a CCP. For each trade, at least the following must be reported: (i) identity of the parties, (ii) type of derivative, (iii) maturity, (iv) nominal value, (v) price, (vi) settlement date, and (vii) currency.

d) Duty to Mitigate Risk (Articles 99 et seq. FMIA)

Derivative transactions that are not cleared through a FINMA approved or recognized CCP are subject to certain risk mitigation obligations. Financial and Non-Financial Counterparties (except for Small Financial and Small Non-Financial Counterparties) must assess, monitor and mitigate operational risks and counterparty risks arising from their derivatives transactions. In particular, they must, among other things, timely exchange confirmations, establish appropriate portfolio reconciliation and agree on dispute resolution procedures.

Also, Financial and Non-Financial Counterparties (except for Small Non-Financial Counterparties) must provide sufficient collateral to cover the outstanding exposure. Such collateral must be appropriately segregated from own assets. No collateral needs to be exchanged in case (i) both parties are subject to the same consolidation, (ii) both counterparties are subject to suitable centralized risk assessment, measure and control procedures, (iii) no legal or factual hurdles for the immediate transfer of assets or the repayment of debt exist, and (iv) the trades are not entered into in order to circumvent margin duties.

e) Trading Platforms (Articles 104 et seq. FMIA)

Financial Counterparties (except for Small Financial Counterparties) and Non-Financial Counterparties (except for Small Non-Financial Counterparties) are required to trade standardized derivatives on FINMA approved or recognized trading platforms. FINMA will determine which derivatives need to be traded on trading platforms. The trading obligation also applies if a foreign counterparty of a Swiss counterparty that is subject to the trading obligation would be obliged to trade a derivative on an approved or recognized platform if it had its domicile in Switzerland. Certain exceptions from the trading obligations apply to intra-group transactions.

4) Initial Thoughts on the New Derivatives Rules

The derivatives market is an international and fast developing market. Switzerland cannot afford to stand isolated and aside of current legislative initiatives. Rather, Switzerland is well advised to close the legislative gaps to other leading jurisdictions, such as the EU and the US, as soon as possible. With FMIA, the Swiss legislature has made a step in the right direction. Equivalent legislation ensures that Swiss market participants will continue to have access to international derivatives markets and that foreign market participants may continue to enter the Swiss derivatives market.

The derivatives legislations in the EU and the US are not fully implemented yet. As the Swiss legislative initiative evolves, Switzerland should closely follow international legislation implementations and ensure that the Swiss legislation is not more restrictive than such other legislations. In other words, to safeguard the competitiveness of the

Swiss derivatives market, the Swiss legislator should abstain from introducing a "Swiss Finish" on the new derivatives legislation.

We will continue to monitor and report on FMIA as the legislation evolves.

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How to Buy a Big Block of Shares in an Ongoing Buyback Program?

Reference: CapLaw-2014-7

In a recent decision in the matter of Schindler Holding Ltd (published on 18 October 2013), the Swiss Takeover Board approved the repurchase by Schindler of a significant block of own shares from a single shareholder during its ongoing buyback program requiring Schindler to change its buyback program at market price into a ten-day buyback offer at fixed price addressed to all the holders of shares and participation certificates. The ongoing buyback program at market price had to be suspended for the duration of the fixed-price offer and was resumed thereafter.

By Lorenzo Olgiati/Pascal Hubli

1) Factual Background

Schindler Holding Ltd, Hergiswil (Schindler), a global provider of elevators and escalators, has a share capital of CHF 7,088,764.50 divided into 70,887,645 registered shares and an additional participation capital of CHF 4,617,190.90 divided into 46,171,909 non-voting participation certificates. Both, the registered shares and the participation certificates of Schindler are listed at the SIX Swiss Exchange (Main Standard).

On 3 January 2013, Schindler announced and started a three-year buyback program at market price (*Rückkaufprogramm zum Marktpreis*) for a maximum of 9.5% of its overall equity capital (share and participation capital), with the additional requirement not to repurchase shares in an amount exceeding 3.6% of the equity capital (4,273,284 shares) or participation certificates exceeding 7.9% of the equity capital (9,378,960 participation certificates) (the Ongoing Buyback Program).

During the Ongoing Buyback Program, an existing shareholder, being a member of the pool of anchor shareholders (consisting of the Schindler and Bonnard families, at the time controlling 70.1% of the voting power) offered to sell to Schindler a block of up to 2,366,697 Schindler shares corresponding to 2.0% of Schindler's equity capital (the Block Sale).

Schindler intended to repurchase the offered significant block of shares in the context of its Ongoing Buyback Program. However, considering that the maximum volume of allowed daily buybacks during a buyback program at market price amounts to 25% of the average daily trading volume traded during 30 days prior to the publication of the buyback program (Daily Repurchase Limit; in Schindler's case amounting to only 7,872 shares), Schindler approached the Swiss Takeover Board (TOB). In its initial request to the TOB of 22 May 2013, Schindler applied for a formal exemption from the application of Article 55b (1)(c) of the Stock Exchange Ordinance (SESTO), the new provision setting forth the Daily Repurchase Limit (enacted on 1 May 2013 on the basis of the revised Swiss Federal Stock Exchange Act's provisions combating market abuse (SESTA)).

As a result of feedback received from the TOB, Schindler submitted a changed request to the TOB on 2 July 2013 asking for the approval of the Block Sale within the framework of the Ongoing Buyback Program, subject to and in accordance with the following main accompanying measures:

- The Ongoing Buyback Program shall be suspended with regard to Schindler's shares (but not with regard to the participation certificates);
- Schindler shall make a buyback offer at a fixed price (*Rückkaufangebot zum Festpreis*; Fixed-Price Offer), open for acceptance during 5½ trading days;
- The maximum number of shares to be repurchased shall be published together with the official announcement of the Fixed-Price Offer and the repurchase price shall be within the range of the share price paid for Schindler's shares during 20 days prior to the announcement of the Fixed-Price Offer;
- To the extent the announced maximum buyback volume of the Ongoing Buyback Program of 9.5% of Schindler's equity capital shall not have been reached after the expiration of the Fixed-Price Offer, the Ongoing Buyback Program shall be resumed.

2) Main Considerations of the TOB

2.1) Applicable Law and Legal Framework

The TOB qualified Schindler's request not as a new buyback offer but as a mere modification of the Ongoing Buyback Program's terms and conditions, meaning, a temporary change from a buyback program at market price to a buyback offer at fixed price without changing the buyback volume.

As a consequence, the TOB held that the TOB Circular No. 1 on buyback programs (TOB Circular 1) in its version as applicable at the time of the announcement of the

Ongoing Buyback Program in January 2013 (i.e. the TOB Circular 1 of 26 February 2010) would still apply to Schindler's request and not the more recent versions of the TOB Circular 1 (of 7 March 2013 and of 27 June 2013 respectively).

The TOB also reiterated that ever since their coming into force on 1 May 2013, the revised SESTA and SESTO rules against market abuse aiming at preventing and combating insider trading and market manipulation directly apply to all current buyback programs, including the one at hand. As a consequence, only a listed company setting up a public buyback program meeting all the conditions set forth in Article 55a *et seq.* SESTO may exclude the risk of being charged of an abusive conduct involving insider trading and/or market manipulation and may, thus, enjoy *ex lege* the irrebuttable presumption of admissible conduct ("safe harbor" protection).

For Schindler the Daily Repurchase Limit set forth in Article 55b (1)(c) SESTO meant that a mere 7,872 Schindler shares could be repurchased per trading day under the safe harbor provision – a drop in the Ocean in comparison to the planned Block Sale of 2,366,697 Schindler shares, representing more than 55% of the total volume of Schindler's Ongoing Buyback Program for shares. According to the TOB, the Daily Repurchase Limit, however, does not forbid Schindler to buy back a bigger number of shares. Schindler would, as the TOB rather laconically stated, "only" incur the risk that such transaction violated the prohibition of insider trading or market manipulation.

The question, however, whether a daily repurchase volume (much) bigger than the Daily Repurchase Limit pursuant to Article 55b (1)(c) SESTO could be approved by the TOB for the purpose of an individual block sale to be carried out on one single trading day was expressly left open by the TOB.

2.2) Equal Treatment of Shareholders

As a next step, the TOB examined the compliance of the planned Block Sale with the fundamental principle of equal treatment in public takeover matters, in particular, the equal treatment of (i) all shareholders and (ii) all categories of listed securities of a listed company. It pointed out that any holder of any kind of listed securities of a company must be free to tender its securities under the same conditions into an ongoing buyback program during its entire term.

Based thereon, the TOB concluded that, given the Block Sale's massive volume equaling approximately 55% of the total volume of the Ongoing Buyback Program for shares, a completion of the Block Sale in the context of the Ongoing Buyback Program would give the selling shareholder undue preference over all other holders of shares and/or participation certificates of Schindler. Namely, the TOB argued that due to the Block Sale Schindler would lose its ability to ensure, during the full residual term of the Ongoing Buyback Program, the repurchase of the securities of those holders willing to sell them to Schindler under the Ongoing Buyback Program. Only a conversion of the Ongoing Buyback Program from a buyback program at market price into a Fixed-Price Offer would satisfy the principle of equal treatment, an opinion which the TOB had already expressed in its earlier decision 522/01 dated 4 January 2013 in the matter of *Absolute Invest Ltd.* There the repurchase of a significant block of shares in the context of an ongoing buyback program at market price was also deemed to be inconsistent with the principle of equal treatment and the TOB, thus, imposed a duty on Absolute Invest Ltd to carry out its next (planned) buyback program in the form of a buyback offer at a fixed price offering the same price as paid in the preceding block transaction.

Schindler's respective request to make a Fixed-Price Offer was granted. However, contrary to Schindler's request, the TOB held that the Fixed-Price Offer of Schindler could not only relate to Schindler's shares but also needed to include the listed participation certificates in order to comply with the principle of equal treatment.

2.3) Suspension of the Ongoing Buyback Program

The TOB confirmed Schindler's request for a suspension of the Ongoing Buyback Program (at market price) for the duration of the Fixed-Price Offer, namely based on its practice that a listed company may not maintain two parallel buyback programs for the same purpose (in the case at hand for the purpose of subsequent capital reduction; *see* TOB Decision 519/01 dated 22 October 2012 in the matter of *shaPE Capital Ltd*).

However, the TOB made again clear that the Ongoing Buyback Program would need to be fully suspended, i.e. not only with regard to Schindler's shares but also with regard to the participation certificates.

2.4) Main Terms of the Fixed-Price Offer

The TOB set the following basic guidelines for Schindler's Fixed-Price Offer:

Duration: Schindler had requested its Fixed-Price Offer to be open for acceptance during 5½ trading days only, arguing that the requested acceptance period has become common practice in other capital market transactions, such as share offerings and share placements of listed companies. This request of Schindler was rejected by the TOB. Emphasizing the clear wording in the SESTO (Article 55b (2)(a) SESTO) and the TOB Circular 1 (no 19 of the TOB Circular 1 of 26 February 2010, currently no 17 of the TOB Circular 1 of 27 June 2013), both providing for a minimum offering period of ten trading days for a Fixed-Price Offer, the TOB denied the need to further shorten the ten day offering period.

Offer Price: Pointing out that Schindler may freely set the price of its Fixed-Price Offer, the TOB approved Schindler's proposed price determination formula, subject, however, to a reasonable proportion between the price offered for Schindler's shares and the one offered for the participation certificates.

No Daily Repurchase Limit: According to the TOB, the Daily Repurchase Limits, as applicable for buyback programs at market price (Article 55b (1)(c) SESTO), do not apply to a Fixed-Price Offer. Consequently, the TOB allowed Schindler to freely set the number of shares and participation certificates for its Fixed-Price Offer, as long as (i) the volumes of the two categories would stand in a reasonable proportion and (ii) the overall number of equity securities allowed to be repurchased under the Ongoing Buyback Program would not be exceeded.

3) Summary and Conclusion

In sum, based on the new rules in the SESTA and the SESTO aiming at combating market abuse (insider trading, market manipulation), the safe harbor protection for allowed daily volumes of repurchases of own shares by listed companies during an ongoing buyback program at market price is limited (Article 55b (1)(c) SESTO). If higher volumes are nevertheless repurchased, the respective company risks that such repurchase qualifies as market abusive practice.

How then to buy back a big block of shares in an ongoing buyback program? In its decision in the matter of Schindler, the TOB directed the applicant Schindler to effect its intended repurchase of a significant block of shares offered during its Ongoing Buyback Program at market price by way of (i) changing the Ongoing Buyback Program into a Fixed-Price Offer to all the holders of equity securities of Schindler while, at the same time, (ii) suspending the Ongoing Buyback Program for the duration of the Fixed-Price Offer. If done so, Schindler's repurchase of the offered significant block of shares would be covered by the safe harbor protection of the SESTO.

The question remains, whether there would have been other legal ways under the rules applicable to share buybacks of listed companies to allow Schindler's Block Sale during its Ongoing Buyback Program.

In particular, as initially requested by Schindler (see Section 1 above), the question arises whether the TOB could grant a ***formal exemption from the application of the buyback restrictions*** set forth in Article 55b (1)(c) SESTO, particularly (but not exclusively) in a situation where a listed company is offered to repurchase a significant block of own shares. While pursuant to Article 55b (3) SESTO the TOB is on the one hand competent to increase the repurchase volume without an express limitation, no legal basis can be found which would, on the other hand, empower the TOB to go one step further and grant exemptions from the provisions of the SESTO (in analogy to Article 4 of the Takeover Ordinance). This result might be regrettable from a practitioner's perspective, the more as such competence of the TOB would mitigate some inconsistencies deriving from the newly introduced split of the takeover and market abuse rules and the respective separate supervision by the TOB and the Swiss Financial Market Supervisory Authority (FINMA).

Finally, the TOB itself has asked but not answered the question whether it could approve a ***very significant increase of the allowed daily repurchase volume*** according to Article 55b (1)(c) and (3) SESTO for the purpose of carrying out a large individual block sale at one trading day (see Section 2 above).

In that respect, the TOB's scarce practice relating to the new Article 55b (3) SESTO is not (yet) supportive. In its decision 537/01 dated 22 July 2013 in the matter of *Castle Alternative Invest Ltd.*, the TOB held that an increase of the Daily Repurchase Limit could in particular be considered (i) in cases where the listed securities are illiquid (in the sense of TOB Circular No. 2) or (ii) if the trading activity in a specific equity security during 30 days prior to the announcement of a buyback program at market price was exceptionally low (leading in the case of Castle Alternative Invest Ltd. to an increase of the Daily Repurchase Limit from 25% to 37.5%). However, the wording of Article 55b (3) SESTO does not exclude a (substantial) increase of the Daily Repurchase Limit for the purpose of a repurchase of a significant block of shares on one trading day, either. For cases with a more moderate ratio between the volumes of a block sale and an ongoing buyback program than in the matter of Schindler, in line with the principle of equal treatment, it seems of practical value that the TOB explores and develops a pertinent practice allowing the repurchase of a block of shares pursuant to Article 55b (3) SESTO.

TOB Decision 525/01 dated 26 July 2013 in the matter of *Schindler Holding Ltd* (published 18 October 2013)

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Nestlé SA sells its stake in Givaudan SA

Reference: CapLaw-2014-8

In December 2013, Nestlé SA sold its 926'562 shares, representing an approximate 10.03% stake, in the Swiss fragrance and flavour maker Givaudan SA. Nestlé SA had acquired the shares in 2002 when it sold Givaudan SA its food ingredient company FIS for a combination of cash and stock worth CHF 750 million. The transaction was executed by way of an institutional private placement through an accelerated book-building transaction led by Goldman Sachs. On the day of announcement, the stake represented approximately CHF 1.14 billion (ca. USD 1.27 billion) of market capitalization.

11th Stock Corporation Law Conference of Zurich (11. Zürcher Aktienrechtstagung)

Wednesday, 26 March 2014

11th Financial Markets Law Conference of Zurich (11. Zürcher Tagung zum Finanzmarktrecht)

Wednesday, 9 April 2014, 9.15 h – 16.20 h, Lake Side Casino Zürichhorn, Zurich

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