New rules on insider dealing and market manipulation

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On May 1, 2013, the revised Federal Act on Stock Exchange and Securities Trading (SESTA) entered into force which brought new rules on insider dealing and market manipulation. The new rules provide for a fundamental change in Swiss criminal and administrative law. In particular, the definition of an insider has been extended and a far reaching intervention competence of the Swiss Financial Market Supervisory Authority (FINMA) has been implemented which may include the confiscation of profits.

New administrative law provisions

The revised SESTA provides for a new administrative law concept of insider dealing on the one hand and market manipulation on the other hand. The new provisions will be enforced by FINMA and apply to all natural persons and all legal entities, i.e. not only FINMA regulated entities, and relate to all securities traded on a stock exchange or similar platform in Switzerland (such securities hereinafter the "Admitted Securities"). These rules can be enforced abroad based on judicial assistance requests from FINMA.

Unlawful dealing with inside information

The revised administrative law prohibiting insider dealing states that any person who knows or should know that information constitutes inside information acts unlawful if they (i) exploit such information to acquire or dispose of Admitted Securities or employ financial instruments deriving from such securities, or (ii) communicate such information to another person, or (iii) exploit such information to make a recommendation to another person to acquire or dispose of Admitted Securities or to employ financial instruments deriving from Admitted Securities.

With regard to this provision, the following aspects are worthwhile mentioning:


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- contrary to the criminal law provisions, the administrative provisions on dealing with inside information do not require any intent and / or financial benefit on the part of any person;
- the term "inside information" is defined as any confidential information which, if made public, is likely to have a significant impact on the market price of Admitted Securities;
- the term "financial instruments" also includes non-standardised OTC products. It is furthermore of no relevance whether the financial instruments are traded on a platform or not and whether such trades are executed in Switzerland or abroad. The decisive question is solely whether or not these financial instruments derive from Admitted Securities;
- the term "exploit" requires that the transaction was done based on the inside information. Accordingly, the new FINMA circular 2013/8 on market behaviour states that transactions, which despite one or both parties having knowledge of inside information were demonstrably not made based on such information and would have been made even without such knowledge being available, are not prohibited. On the other hand, the modification or cancellation of execution orders relating to Admitted Securities (or financial instruments deriving therefrom) for which inside information was available qualifies as exploitation of inside information even if the original order was given before the inside information was obtained.

Market manipulation

The provisions prohibiting market manipulation state that any person acts unlawful if they (i) publicly disseminate information of which they know or should know that such dissemination will send wrong or misleading signals regarding the offer, demand or market price of Admitted Securities, or (ii) effect transactions or place purchase or sales orders of which they know or should know that such transactions, purchase or sales orders will send wrong or misleading signals regarding the offer, demand or market price of Admitted Securities.

Particular rules for regulated persons

While the administrative law provisions on insider dealing and market manipulation apply to any natural person and legal entity, the FINMA circular 2013/8 on market behaviour stipulates further provisions applicable to persons supervised by FINMA. By way of these rules, the actions relevant for unlawful dealing with inside information and for market manipulation are further broadened by including (i) dealing in securities on the primary market, (ii) securities admitted for trading only on a foreign stock exchange or a similar foreign platform, and (iii) business activities in markets other than securities market (such as commodities, foreign exchange and bond markets).

New criminal law provisions

The provisions on criminal insider dealing and market price manipulation have been transferred from the Criminal Code to the SESTA. At the same time, the scope of prohibited behaviours and actions has been significantly extended under the new criminal provision on insider dealing.

Unlawful dealing with insider information

The criminal provision centres around the so-called primary insider who can be punished with up to three years imprisonment or with a fine if they obtain for themselves or for another person a financial advantage by (i) exploiting inside information to acquire or dispose of Admitted Securities or by using financial instruments derived from such Admitted Securities, or (ii) exploiting inside information to make a recommendation to another person to acquire, dispose or use such Admitted Securities or financial instruments, or (iii) communicating such inside information to another person.

The term "primary insider" under the old provision only included members of the board of directors and management, the auditors and agent of either the issuer or of a person controlling or controlled by the issuer. So far, in particular major shareholders only could have been become primary insiders within the meaning of the criminal laws if they at the same time were at least de facto directors. The revised provision on insider dealing has closed this gap by also covering persons as primary insider who receive

information due to a participation they own. Furthermore, additional internal staff of the company may fall under the definition of a primary insider, if they are entitled to receive the sensitive information in the course of their duties. This may for example apply to members of the legal department or scientific research unit.

Contrary to the primary insiders tippees are persons who have received inside information from a primary insider or obtained such information from another crime or offence. Tippees will be punished with a fine if they (for themselves or another person) obtain a financial advantage by exploiting such inside information to acquire or dispose of Admitted Securities or by using financial instruments deriving from Admitted Securities.

In addition, and rather surprisingly so, even persons who only accidentally receive knowledge of inside information will be insider in the sense of the criminal provisions and hence are prohibited from obtaining (for themselves or another person) a financial advantage by exploiting this inside information to acquire or dispose of Admitted Securities or by using financial instruments deriving from Admitted Securities.

Market price manipulation

Whilst the provisions on insider dealing have been extended, the criminal law provisions on market price manipulation remained unchanged in principle. Accordingly, a person will be punished with up to three years imprisonment or with a fine if such person (i) against better judgement disseminates wrong or misleading information, or (ii) effects sales and purchases of securities which are executed both on the buy and sell side to the direct or indirect benefit of the same persons, with the aim to significantly influence the price of Admitted Securities, thereby achieving a financial advantage for itself or another person.

Safe harbour rules

Considering the scope and definition of insider dealing and market manipulation under the new administrative law, various common market practices and market behaviours would qualify as prohibited behaviour or action.

Swiss government was aware of this and adopted a revised Ordinance on Stock Exchange and Securities Trading (SESTO) which entered into force together with the revised SESTA on May 1, 2013. The revised SESTO provides for several safe harbours on insider dealing and market manipulation. These safe harbours are exhaustive and apply to both the new administrative law provisions and the criminal law provisions.

Share buy-backs

The revised SESTO provides for detailed rules (namely concerning duration, amount and price) for share buy-back programs which, if adhered to, operate as a safe harbour under the rules on insider dealing and market manipulation. As a consequence of the revised SESTO, the Swiss Takeover Board published a new circular No. 1 on share buy-backs and abolished its previous circular No. 4.

The safe harbour for share buy-backs according to SESTO only applies to shares but not to debt participations.

Stabilisation upon public offering (IPO)

Trading in securities for the purpose of stabilisation of the price is permitted if (i) such trading is made within 30 calendar days from the public placement of the respective securities, (ii) made at a price which is higher than the offer price or, in case of subscription and conversion rights, not above their market price, (iii) the maximum period during which stabilisation may occur and the identity of the securities dealer who has been appointed as stabilisation agent have been published prior to start trading the relevant security, (iv) no prices are quoted while trading is suspended as well as during the opening and closing auctions, (v) the stock exchange has been notified of any stabilisation activities within five trading days after they were made and the issuer has published a notice of such activities within five trading days from expiry of the stabilisation period, and (vi) the issuer has informed the public within five trading days after exercise of any over-allotment option about the time of exercise and the relevant number and type of securities.

It is important to note that the safe harbour only applies if stabilisation measures are taken in the context of a public placement. Hence, the safe harbour would not be available in case of private placements.

Certain security transactions

In addition to the safe harbours for share buy-backs and for stabilisation purposes, there are two further safe harbours with regard to insider dealing and market manipulation which are the following:

(i) transactions in securities to implement one's own decision (since nobody can be his own insider), in particular the acquisition of shares in a target company by the potential offeror in preparation of a public tender offer, provided that the offeror has no inside information (neither on the target company nor on the potential offeror and nor other inside information); and

(ii) transactions in securities by the Swiss Confederation, cantons, communities and the Swiss National Bank in connection with the performance of their public duties, provided they are not made for investment purposes.

While it is welcomed that the principle of "nobody can be their own insider" has been adhered to, the principle that dealings between insiders do not constitute insider dealing has been explicitly excluded from the safe harbour. It therefore remains questionable whether a major shareholder in a listed company who is negotiating with a potential buyer to obtain a favourable price for his stake may be deemed to be engaged in insider trading if he is aware that the buyer will thereafter make an offer for all shares in the company.

Permitted communication of inside information

Certain communication of inside information is exempt from and is not prohibited under the insider dealing and market manipulation provisions. This exemption applies if (i) the recipient needs to have this information to perform statutory or contractual duties and obligations, or (ii) the communication of such information is a prerequisite for entering into a contract and the person holding such inside information emphasises towards the recipient not to exploit the inside information and records the fact that inside information has been provided and that the recipient has received the statement not to exploit the inside information.

Considering the foregoing and given the fact that pre-sounding activities and the granting of due diligence access in connection with M&A transactions are common market practice, it will be important that confidentiality agreements and data room rules contain warnings relating to the new laws, i.e. emphasise the existence of inside information and the duty not to exploit the same. The issuance of these warnings must be appropriately recorded by the company.

Further exemptions

Further to the exemptions set out by law, the Swiss government has clarified that the following behaviours are exempted per se from the scope of prohibited insider dealing and market manipulation: (i) transactions in securities made with inside information but without causality between such transactions and the inside information, (ii) price management to provide liquidity to the market in order to reduce large price fluctuations, provided that no misleading signals are sent to the market participants, (iii) market making, and (iv) transactions made on different markets for arbitrage purposes.

Conclusion

The new laws bring significant changes, not only relating to the scope of the criminal offence in the case of insider dealing, but in particular due to the new dual regime of administrative supervision and criminal offence, which can mean that persons caught in alleged insider dealing or market manipulation may find themselves confronted with two separate proceedings for the same action.

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