

New Rules on Market Abuse Proposed



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A commission of experts established by the Swiss Federal Council to consider how to increase the effectiveness of securities market regulation recently delivered its report (the "Report") on securities market crimes and market abuse ("*Börsendelikte und Marktmissbrauch*"). The Report proposes various revisions to ensure that Swiss securities markets function properly. This NewsLetter outlines the proposals.

Background

As noted at the outset of the Report, the mere suspicion that securities market participants are engaged in insider trading, price manipulations or other abusive practices can lead to uncertainty, a loss of trust and decreasing trading volumes. Market abuses may also lead to prices which do not correctly reflect supply and demand, causing a misallocation of resources and, as a result, harm to the economy.

Insider trading – trading on the basis of confidential information which is relevant to the market price of a security – has been subject to punishment by imprisonment or a fine under the Swiss Penal Code for more than 20 years. Nevertheless, because there has been, on average, fewer than one conviction per year, this statistic is sometimes cited as evidence that the law is not effective.

Procedural findings

The Report cited the broad distribution of regulatory responsibilities as one of the basic reasons for the inadequacy of current market conduct regulation. Today, six different authorities or types of institutions are charged with investigating market abuses: the securities exchanges, the Swiss Financial Market Supervisory Authority (FINMA), the Federal Department of Finance, the Federal Attorney General, the cantonal prosecutors and the civil judges. This complexity and the risk of parallel proceedings lead to inefficiencies and new problems: for example, how is a market participant's duty to cooperate with a regulatory investigation to be reconciled with his or her legal protection against self-incrimination.

The Report's findings on issues of substantive law

According to the Report, the current definition of an "insider" is too specific. The current law targets only the members of the board of directors, the members

of the managing board, the auditors or a corporation's agents (or those of another corporation that is either controlled by, or dependent on, the relevant corporation); members of a public body or a public official; or those assisting one of the aforementioned persons. Insider trading rules in other countries apply a more general approach to the definition of the insider, for instance "any person, [...], who possesses inside information while that person knows, or ought to have known, that [it] is inside information" (Article 4 of the European Union Market Abuse Directive, MAD). In Germany and the UK for instance, persons who acquire inside information through criminal activities (e.g., by industrial espionage) or by accident (e.g., by receipt of an incorrectly addressed email) are also insiders.

The price manipulation offence in Switzerland is confined to acts which "considerably" influence the price of a traded security. Again, the corresponding rules in Germany and the UK protect the market in general, i.e., they also prohibit the manipulation of other important indicators such as trading volumes or the number of trades. Swiss law addresses fictitious transactions only in a limited way.

New insider trading crime

The Report concludes that some foreign laws against insider trading are more precise and are to be preferred. The Report therefore proposes a new version of the offence which should be included in the Securities Exchanges Law. According to the proposal, any person with knowledge of insider information – not just members of the board or directors or the managing board of the relevant company with such knowledge – can violate the law.

The proposal also distinguishes among three types of insiders: primary insiders, who are persons with

direct access to confidential information which is relevant to the price of a security; secondary insiders, who are persons which have obtained information directly or actively from a primary insider (e.g., the partner of a primary insider or persons who have obtained confidential information by criminal means (e.g., through a computer crime); and accidental insiders, who are persons who received inside information by mistake. The proposal would subject accidental insiders to punishment which is less severe than that imposed on primary and secondary insiders because the accidental insider does not have a duty of loyalty to the source of the insider information.

Market manipulation

The commission of experts does not, after careful consideration, propose to add "squeezing" (establishing a large position in a security with the intention of constricting the market), "spoofing" (entry of fictitious orders for large blocks with the intent to cancel them immediately) or "ramping" (the distortion of liquidity or prices by creating an overhang of buy or sell orders) to the list of market abuse crimes. These types of conduct should, however, remain prohibited for regulated market participants such as banks or brokers. Other market abuses, such as "front running" (trading by a securities dealer based on its knowledge of its customers' pending trading orders) or "scalping" (the purchase of securities by a dealer or investment adviser shortly before recommending the purchase of the same securities and then selling the securities at a profit when the price rises following the recommendation), should now be prohibited for all market participants that are supervised by the FINMA. The market manipulation offence should also be moved to the Securities Exchanges Law.

Competences and proceedings

Because of the complexity of the matter, the main objective of the proposals of the commission of experts was the centralisation of authorities and proceedings. Criminal and administrative proceedings should nevertheless not be combined in order to protect rights against self-incrimination. It is proposed that criminal proceedings be transferred to the office of the Federal Attorney General and that the FINMA performs preliminary administrative investigations. Under the proposal, the court of first instance for criminal proceedings would be the Federal Criminal Court with the possibility of an appeal to the Federal Supreme Court. The Report's alternative, but less preferred proposal for the centralisation of the criminal proceedings is to have them conducted by cantonal prosecutors in the jurisdiction where the stock exchange has its registered office (i.e., Zurich in the

case of the SIX Swiss Exchange) or the Federal Department of Finance. The commission of experts also expects that the published decisions of the FINMA under the modified procedures will quickly yield a body of regulatory decisions that market participants can use as guidance.

Conclusion

The Federal Council is expected to act on the proposals made by the group of experts in the coming months. The proposed alignment of Swiss law with the European Union's Market Abuse Directive would enhance Switzerland's position as a financial centre by strengthening criminal sanctions against insider trading and other abusive securities trading practices.

The ww&p NewsLetter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

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