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Amendments to the EU Prospectus Directive—Key Changes of which Swiss Issuers and Capital Markets Practitioners Should be Aware

Reference: CapLaw-2010-51

On 11 October 2010, the European Council adopted amendments to the EU Prospectus Directive (2003/71/EC) that will impact both debt and equity offerings within the European Economic Area (EEA) following implementation (*i.e.* transposition into national law) by the various EEA Member States, which is expected to happen by June 2012. This article highlights certain key changes to the Prospectus Directive of which Swiss issuers and capital markets practitioners should be aware. The amendments are relevant for the many Swiss issuers that access the EEA capital markets as they include a number of notable clarifications and changes to the EU Prospectus Directive. For example, the amendments will simplify the operation of employee share plans by certain Swiss companies with a significant number of employees in the EEA as well as rights issues to shareholders in the EEA.

By Bernd Bohr / Daniel Bono / Jennifer Cresswell / Véronique Legoff

On 11 October 2010, the European Council adopted amendments to the Prospectus Directive following the European Commission's review, which was mandated to be undertaken five years from its entry into force at the end of 2003. It is expected that the directive which enacts the amendments (Amending Directive) will come into force in December 2010 or January 2011. Member States will then have 18 months to implement the Amending Directive by transposing it into national law. The necessary changes to the relevant national laws are therefore expected to be in place in all EEA Member States by June 2012. Consequential amendments to Regulation (EC) 809/2004 (Prospectus Regulation), which sets out the detailed requirements for the format and content of prospectuses, will be made by the EU Commission, although the timing of these amendments is not yet known.

This article highlights certain key changes to the Prospectus Directive of which Swiss issuers and capital markets practitioners should be aware, but is not intended as an exhaustive summary of all changes included in the Amending Directive.

1) Key Amendments Relevant for All Offerings

The following key changes to the Prospectus Directive will be relevant for both debt and equity offerings within the EEA.

a) The Prospectus Summary

The amendments, once implemented, will require significant changes to the format and contents of the prospectus summary. In particular, the format of the summary will generally be more prescriptive to facilitate comparability of the summaries of similar securities. In addition, the summary will have to provide certain 'key information' to enable investors to understand the nature of, and risks associated with, the issuer, any guarantor and the securities being offered so they can decide which offers of securities to consider further. The word limit of 2,500 words set out in a recital to the Prospectus Directive does not appear to have been removed by the amendments, which means it will continue to be challenging to meet the summary requirements within the specified word limit.

Further legislation will have to be adopted by the European Commission in relation to the detailed content and specific format of the summary. A recital to the Amending Directive notes that such legislation will need to be aligned with the outcome of the European Commission's ongoing efforts in relation to Packaged Retail Investment Products (PRIPs). This is going to be a key area to focus on in the coming year and there is concern as to how the PRIPs requirements can be meaningfully complied with in a vanilla debt or equity context.

b) Prospectus Supplements and Withdrawal Rights

The Amending Directive clarifies that the obligation in article 16 of the Prospectus Directive to produce a prospectus supplement (if a significant new factor, material mistake or inaccuracy relating to the information included in the prospectus, which is capable of affecting the assessment of the securities, arises or is noted after approval) ends at the ***later of*** the closing of the offer period and start of trading in the securities on a regulated market. In addition, the Prospectus Directive is also being amended so that the withdrawal right available to investors (who have already agreed to purchase or subscribe for securities before the supplement is published):

- will only be exercisable if the prospectus which is being supplemented related to a non-exempt offer of securities to the public and not if it related only to the admission of securities to trading on a regulated market (it is understood that this is the correct interpretation of the relevant provision of the Amending Directive, although the drafting of the provision is not entirely clear);

- will have to be exercised *within* two working days, unless the issuer or offeror extends the period—the current provisions require a minimum period of two working days, thereby allowing for national laws that provide for longer periods; and

- will only be exercisable within the two working days if the new factor, mistake or inaccuracy arose before the final closing of the offer and the delivery of the securities.

c) Changes to the 'qualified investor' Definition

The Prospectus Directive provides for an exemption from the obligation to publish a prospectus for offers addressed solely to 'qualified investors'. The Amending Directive will align the definition of 'qualified investor' with the 'professional client' and 'eligible counterparty' categorizations applied to investors in the Markets in Financial Instruments Directive (MiFID). This is generally considered a useful amendment, as it should reduce the administrative burden on investment firms of maintaining a separate register of qualified investors.

d) Extension of the 100 Person Public Offer Exemption

The threshold for the public offer exemption in article 3(2)(b)—the '100 persons per Member State' exemption—will increase from 100 to 150 natural or legal persons (other than qualified investors) per Member State.

e) Removal of the Obligation to Produce an Annual Information Update

The Amending Directive will delete article 10 of the Prospectus Directive, which currently requires an issuer of securities admitted to trading on a regulated market to publish an annual information update. This requirement has become obsolete following implementation of comprehensive periodic and ongoing disclosure requirements under the Transparency Directive.

f) Website Publication of the Prospectus

The Amending Directive will require publication of a prospectus in electronic form on the issuer's or financial intermediaries' website(s) where it is published by one of the permitted 'paper' methods (electronic publication is already permitted in various forms).

Although systematic website publication will result in better accessibility for investors, it will still be necessary to consider potential securities law implications in other jurisdictions of electronic publication of the prospectus. For example, it will likely remain necessary to employ 'click-through screens' to ensure that the electronic publication of the prospectus will not be deemed a public offer in the US in violation of SEC registration requirements.

2) Key Amendments Relevant for Debt Offerings

The following key amendments to the Prospectus Directive are relevant for debt offerings within the EEA.

a) 'Wholesale' Debt Threshold

The 'wholesale' debt threshold, which is relevant for determining appropriate prospectus disclosure requirements and for prospectus exemption purposes, will increase from

EUR 50,000 to EUR 100,000, or its equivalent in another currency. There are also concerns that the Commission may use its newly granted powers under the Amending Directive to adopt further legislation to make 'inflation related' adjustments to the denominations referred to in the Prospectus Directive on an ongoing basis which could cause difficulties in the debt capital markets where the practice is to use rounded denominations.

b) Retail Cascades

The term 'retail cascade' refers to the practice in the debt capital markets of offering debt securities with denominations of less than EUR 50,000 through financial intermediaries. Under the Prospectus Directive, each offer in the selling chain must be covered by a prospectus (*i.e.* either by the issuer's prospectus or by a prospectus prepared by the offeror), unless an exemption is available. The Amending Directive amends article 3(2) of the Prospectus Directive so as to clarify that a separate prospectus will not be required for a resale or final placement of securities through financial intermediaries so long as there is a valid prospectus and the issuer consents to its use by means of a written agreement. It is anticipated that an industry standard form of such an agreement will be developed.

c) Information Permitted to be Included in 'Final Terms'

In connection with debt issuance programmes used by many issuers for the continuing issuance of debt, it is common practice to document the terms of individual debt issuances by way of a 'final terms' document (in the pre-Prospectus Directive world, a 'pricing supplement') which does not require competent authority approval rather than by a prospectus supplement which does require competent authority approval and triggers article 16 withdrawal rights as described above. The Amending Directive includes a recital intended to clarify that the information which can be included in final terms 'might for instance include ISIN, issue price, maturity, coupon, exercise date, exercise price and redemption price and other terms not known at the time of drawing up the prospectus'. It is unclear what the exact meaning of this is and what effect it will have, although it may re-open the final terms versus supplements debate which has been ongoing since implementation of the Prospectus Directive—this would be unwelcome.

d) Consequential Amendments to the Transparency Directive—the 'Wholesale' Debt Threshold and Exemption

The Amending Directive will also make certain consequential changes to the Transparency Directive, including by increasing the 'wholesale' debt threshold from EUR 50,000 to EUR 100,000 in relevant provisions of the Transparency Directive. This will impact on the exemption in article 8 of the Transparency Directive from the financial reporting requirements under articles 4 and 5 of the Transparency Directive for issuers of exclusively debt securities with denominations of EUR 50,000 or above. Following the date of entry into force of the Amending Directive (which is currently expected to be in December 2010/January 2011), the exemption from the financial reporting requirements under the Transparency Directive will only be available for new or further issues with denominations of EUR 100,000 or above.

However, issuers of exclusively debt securities with denominations of EUR 50,000 (or equivalent) or above which are admitted to trading on a regulated market *before the date of entry into force of the Amending Directive* will be grandfathered and will be able to continue to rely on the exemption in its current form.

e) Choice of EEA Home Member State for Debt Securities with a Denomination below EUR 1,000

Under the Prospectus Directive, non-EEA issuers of equity securities and debt securities with a denomination below EUR 1,000 are deemed to have as their EEA home Member State (*i.e.* the EEA Member State responsible for, among other things, approving prospectuses) the EEA Member State where the initial public offer or initial application for admission to trading of such securities is made and such EEA home Member State cannot be changed for issues of such securities thereafter. Issuers of debt securities with a denomination of at least EUR 1,000, on the other hand, can choose their EEA home Member State on an issue-by-issue basis. In a recital, the Amending Directive indicates that the EU Commission will review the EUR 1,000 limitation to decide whether it should be maintained or amended. Should the EU Commission ultimately decide to abolish the EUR 1,000 limitation, this would be a welcome change as it would further increase the flexibility of Swiss and other non-EEA issuers when accessing the EEA capital markets. It is likely too early to speculate on when the EU Commission will reach a decision on this question.

3) Further Key Amendments Relevant for Equity Offerings

The following key amendments to the Prospectus Directive are relevant for different types of equity offerings within the EEA.

a) New 'Proportionate Disclosure Regime' for Offers to Existing Shareholders

The Amending Directive introduces a 'proportionate disclosure regime' for offers of shares to existing shareholders, such as rights issues. The new regime will only apply to offers of shares of the same class as those already admitted to trading on a regulated market or on a multilateral trading facility which imposes appropriate on-going disclosure requirements and rules on market abuse. The new regime will only apply when the issuer has not disapplied statutory pre-emption rights.

The introduction of a short-form prospectus is intended to improve the efficiency of pre-emptive issues of equity securities, but the Commission has yet to specify the exact disclosure requirements of short-form prospectuses by way of amendments to the Prospectus Regulation. As far as the authors of this article are aware, the only existing proposal for what information should be included in short-form prospectuses was published as a set of recommendations by the Rights Issue Review Group in the United Kingdom in November 2008. It will be interesting to see whether and to what extent the Commission will follow those recommendations.

b) Extension of the Total Consideration Exclusion and Merger Exemption

The Amending Directive will extend the total consideration exclusion and the merger exemption from the requirement to publish a prospectus as follows:

- the 'EUR 2,500,000 total consideration' public offer exclusion threshold will be raised to EUR 5,000,000 (calculated on an EU-wide basis); and
- the merger exemption (which is available for both public offers and admission of securities to trading on a regulated market) will be extended to divisions (such as demergers).

Helpfully, the Amending Directive grants the Commission the power to adjust the relevant limits in the future.

c) Extension of the Employee Share Plans Exemption

The exemption from the requirement to publish a prospectus for offers to employees will be extended to companies with securities admitted to trading on a third-country market 'equivalent' to an EU-regulated market and to companies whose head office or registered office is in the European Union. Historically, the employee share plans exemption has been implemented inconsistently in different Member States, with some (*e.g.* Spain) requiring that a company must have its shares (rather than just debt securities) admitted for trading on an EU-regulated market. In order to benefit from the exemption, companies with securities admitted to trading on an EU-regulated market to whom the exemption applies and companies whose head or registered office is in the EU must publish a 'summary document' containing information on the number and nature of the securities offered, and the reasons for and details of the offer. This information can usually be included in the explanatory booklet provided to employees. Companies with securities admitted to trading on an 'equivalent' third country market must provide employees with 'adequate information' on the offer, including the summary document. It remains to be seen how this 'adequate information' requirement will be implemented.

The Commission will determine whether a third country market is 'equivalent', taking into account certain requirements specified in the Amending Directive relating to the third country's legal and supervisory framework. It is expected that major United States exchanges, including the NYSE and NASDAQ will be determined to be 'equivalent' markets. This may well be helpful for a number of Swiss companies with a significant number of employees in the European Union and a listing on one of the major US exchanges, but with no EU (equity) listing. These companies include, for example, ACE Limited, Credit Suisse AG, Garmin Ltd., Novartis AG, Syngenta AG, Tyco International Ltd., UBS AG and Weatherford International Ltd. Those companies may then no longer have to consider whether a (Prospectus Directive-compliant) prospectus will be required in order to operate their employee share plans consistently throughout the European Union. It remains to be seen whether the SIX Swiss Exchange, will be determined to be an 'equivalent' market.

4) Summary / Conclusion

The Amending Directive and resulting changes to national securities laws in the various EEA Member States will be relevant for the many Swiss issuers that access the EEA capital markets as they include a number of notable clarifications and changes to the EU Prospectus Directive. For example, the amendments will simplify the operation of employee share plans by certain Swiss companies with a significant number of employees in the EEA as well as rights issues to shareholders in the EEA. Swiss issuers and capital market practitioners are therefore well advised to familiarise themselves with the amendments and to watch this space as the Amending Directive will be implemented by individual EEA Member States and the EU Commission will make consequential changes to the Prospectus Regulation.

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Update on the New Rules on Stock Exchange Offences and Market Abuse

Reference: CapLaw-2010-52

By Petra Ginter

In CapLaw-2010-2, we presented a preliminary overview on the draft bill with respect to the revision of the Stock Exchange Act that the Federal Council had sent into consultation until 30 April 2010. The initial consultation draft has proposed more effective and efficient provisions to sanction misconduct in the market, in particular, with a view to developments in international regulations for securities markets. At its meeting on 8 September 2010, the Federal Council took note of the findings received in connection with the consultation procedure and instructed the Federal Department of Finance (FDF) to prepare a message *(Botschaft)* by spring 2011 to amend the Stock Exchange Act.

In terms of content, the tests for criminal prosecution of insider trading will need to be revised. In addition, new first degree incriminated conduct on insider trading and market manipulation that qualify as crimes *(Verbrechen)* are to be introduced. The criminal appeal procedures will be streamlined by transferring the authority to prosecute and assess stock exchange offences to the Office of the Attorney General of Switzerland (OAG) and the Federal Criminal Court (FCC). The regulatory ban on market manipulation will also apply to unregulated entities, such as hedge funds and private investors; FINMA will receive authority to sanction any violations within the scope of administrative proceedings.

Some issues, such as how far market supervision should be extended to unregulated entities or the amount of fines afforded to a breach of shareholdings disclosure obligations, require an in-depth examination. The Federal Council has instructed the FDF to carry out further investigations and to make a proposal on the further course of action by the end of 2010.

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Certainty of Funds in Acquisition Finance

Reference: CapLaw-2010-53

In a public takeover, the bidder must ensure that it will have the funds available to fulfill all its obligations under the offer—it must have 'certain funds' available. The certainty of funds must be confirmed by the review body *(Prüfstelle).* The following article explains how the certain funds requirements may be met, taking into account different financing sources for the offer.

By Ansgar Schott

1) Legal Basis

In a public takeover, the bidder must ensure before it makes the offer that it will have the funds available to fulfill all its obligations under the offer, which in legal jargon is simply referred to as ***certain funds.*** The certain funds requirement is based on article 20 of the Ordinance of the Swiss Takeover Board on Takeover Offers (Takeover Ordinance), which states that the offer prospectus must contain the essential details of the financing of the offer as well as confirmation from the review body that the bidder has taken the necessary measures to ensure that the required funds will be available on the settlement date (para. 1); if securities offered in exchange are not yet available, the review body must confirm that the bidder has taken all the necessary measures to ensure that the securities will be available on the settlement date (para. 2).

The financing source for a ***cash offer*** can be existing cash, an acquisition finance facility, other debt finance sources and/or equity finance (see at 2) below). The financing source for an ***exchange offer*** can be existing shares or new shares (see at 3) below). The principle of certain funds means that there must be sufficient funds available to finance the entire offer, including any minority squeeze-out. The review body will, before confirming the certainty of funds, conduct its own due diligence—it must take reasonable care in reaching its conclusion that the funds will be available. In practice, it is necessary not only to have executed documentation under which the bidder has received commitments for sufficient funding, but also to have met all conditions precedent to drawdown thereunder.

2) Sources of Finance in a Cash Offer

a) Existing Cash Resources

A cash offer may be financed with existing cash resources. Normally, the bidder must provide the review body with its interim balance sheet as well as a bank account statement showing that the funds are available. Further, the review body may ask the bidder for a confirmation that such funds are free of any liens and can be made available at the settlement date. Securities of the bidder will only be considered for purposes of meeting certain funds requirements if they can be easily converted into cash and, in such case, may only constitute a limited portion of such funds and will be considered at a discount. In certain cases, the review body may even require comfort that the funds are kept in a blocked account.

b) Acquisition Finance Facilities

As a rule, the facility agreement must be in place at the time of the offering (the term sheet or the engagement letter of the lead agent are not a sufficient confirmation for certain funds purposes). In the case of a prior announcement (articles 5 et seq. Takeover Ordinance), it is advisable to have already prepared the documentation at the time of the prior announcement because of the bidder's obligation to pursue the offering process *(Fortführungspflicht).* In the case of reputable lenders, the review body does not have to make any inquiries into the solvency and soundness of the lenders.

Acquisition finance facilities often provide for a separate certain funds clause, which sets out the certain funds period and the circumstances under which the lender may decline to lend or may accelerate repayment of the loans within that period. Although details are subject to negotiation, ***grounds for refusal to lend*** should be limited to: (i) illegality and incapacity of the bidder; (ii) insolvency of the bidder (not the target); (iii) material adverse change relating to the bidder (not the target); (iv) any matters that are wholly within the bidder's control; and (v) offer conditions not being satisfied. The ***certain funds period*** starts on the date the facility agreement is signed and ends on the settlement date of the offer. The certain funds period may be subject to a long-stop date (the last possible day on which the financing will be available, irrespective of whether or not the settlement date has occurred), provided that the longstop date is reasonable, *i.e.* not every possible event that could delay the process must be taken into account.

c) Other Debt Finance Sources

Existing credit facilities of the bidder may only be used for certain funds purposes, if they meet the requirements set out above. Loans from investors are often unconditional commitments and, hence, valid certain funds sources. In this case, the review body must focus on the investor's solvency and soundness. In addition, the offer may be financed through the issuance of debt instruments (bonds). The review body should verify that the debt instruments are underwritten by reputable underwriters.

d) Equity Finance

Cash to be used for the offering may be sourced from an ordinary or authorized capital increase of the bidder (see at 3) below). If the equity is underwritten by reputable underwriters, the review body is not required to make any inquiries into the solvency and soundness of the underwriters.

3) Use of Shares in an Exchange Offer

a) Existing Shares

In an exchange offer, the bidder exchanges its own shares or shares of an affiliate or a third party for the shares of the target. For the exchange, the bidder may either use existing shares or newly-issued shares. If the bidder is not yet in possession of the existing shares to be offered in exchange and intends to purchase or borrow such shares, the relevant purchase or securities lending agreement must be in place at the time of the offering (or prior announcement, as the case may be). The review body should ascertain that the bidder is in possession of the shares on the settlement date.

b) New Shares in a Non-mandatory Offer

In a non-mandatory tender offer, the offer may be conditioned on the approval of the shareholders to issue the shares that will be exchanged for shares of the target. According to article 20(2) of the Takeover Ordinance, the review body must confirm that the ***bidder has taken all necessary measures*** that the securities it will offer in exchange are available on the settlement day. In practice, this means that: (i) the shareholders meeting has been convened; (ii) the shareholders resolution has been put on the agenda; and (iii) the board of directors' motion has been announced. In the case of an authorized capital increase, the board of directors must pass the resolution to increase the equity capital only when the amount of shares to be offered is certain.

c) New Shares in a Mandatory Offer

In a mandatory offer, the offer must not be contingent on the creation of the shares. As a consequence, the shareholders resolution to increase the share capital or approve the creation of authorized share capital must be passed at the time of the offering. However, the bidder is not required to wait until the two month period of article 706 of the Swiss Code of Obligations (CO) has lapsed (shareholders resolution may be challenged within that period on certain grounds only). Since the (exact) amount of shares to be used for the exchange is not determinable at the time of the offering, the shareholders may approve a maximum amount (which corresponds to the total amount used as consideration of all shares for which the offer has been made). In order to meet the requirements of article 650(2)(4) CO (in the case of contribution-in-kind, the name of the contributor-in-kind must be indicated), either (i) the bidder's shares must be subscribed by a trustee who will then transfer the shares to the shareholders; or (ii) the tendering shareholders are left unknown.

4) Disclosure in the Offering Prospectus

According to article 20(1) Takover Ordinance, the offering prospectus must contain the essential information about the financing of the offer. In practice, this means that the type of source and the approximate percentage of the funds such financing source will provide must be disclosed. For example, the financing language in the prospectus could read: 'The offer will be financed at 10% by existing cash sources of the bidder, at 30% by a commitment from the investor XY and at 60% by a credit facility from a bank syndicate.' Basically, no further details (about the certain funds clause) must be given in the prospectus. However, in certain cases, the Takeover Board may ask the bidder to provide more information about its financing sources.

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The U.S. Dodd-Frank Act—Implications for Foreign Private Issuers

Reference: CapLaw-2010-54

The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or the Act) contains numerous provisions relating to Corporate Governance and Executive Compensation. Some of these provisions will apply not only to domestic United States (U.S.) public companies but may also apply to foreign private issuers, although the extent of their applicability is not yet clear.

By Thomas Werlen / Stefan Sulzer

On July 21, 2010, the Dodd-Frank Act became law (available under http://docs.house.gov/rules/finserv/111_hr4173_finsrvcr.pdf). The Act, a legislative reaction to the financial crisis, contains numerous provisions which may apply to foreign private issuers whose securities are listed in the United States, including Swiss issuers such as ABB Ltd., Credit Suisse, Novartis AG, Syngenta AG and UBS AG.

Below we examine some of the most notable changes with respect to corporate governance and executive compensation imposed by the Dodd-Frank Act and discuss whether the new rules will be applicable to foreign private issuers. Whether these new rules will in fact be applicable to foreign private issuers is not yet clear and depends on the rules adopted by the United States Securities and Exchange Commission (SEC) and stock exchanges.

1) Corporate Governance

a) Proxy Access

The Dodd-Frank Act gives the SEC authority to implement rules requiring public companies to include, in their proxies, nominees designated by shareholders for election to the board of directors (see Section 971 of the Act). This provision is designed to put an end to the controversy that arose last year when the SEC proposed proxy access rules.

A number of interested parties argued that the SEC lacked jurisdiction to regulate the director election process because it was a matter governed by state law. Now that its authority to do so has been clarified, the SEC will likely implement proxy access rules in the near future, but it is likely that it will exempt foreign private issuers from that requirement. Foreign private issuers are generally not subject to the rules governing solicitation of proxies applicable to U.S. public companies.

b) Disclosure of Chief Executive Officer/Chairman Structure

The Dodd-Frank Act creates a new Section 14B (Corporate Governance) of the Securities Exchange Act of 1934 (Exchange Act) and requires the SEC to issue rules mandating U.S. public companies to disclose the reasons why the positions of chief executive officer and chairman of the board are occupied by the same person or by different individuals (see Section 972 of the Act). The Act does not give the SEC authority to exempt foreign private issuers from this new disclosure requirement. This is different from Section 14 of the Exchange Act, which does grant the SEC exemptive authority. The SEC has used this authority, by adopting Exchange Act Rule 3a12-3, to exempt foreign private issuers from the proxy rules (i.e. Sections 14(a), 14(b), 14(c) and 14(f) of the Exchange Act). Because the new disclosure requirement relates to proxy statements but the Act does not give the SEC exemptive authority to exempt foreign private issuers from the new disclosure requirement, it is not yet clear whether this new disclosure requirement will in fact be applicable to foreign private issuers.

c) Broker Discretionary Voting

The Dodd-Frank Act directs U.S. stock exchanges to prohibit brokers from exercising discretionary authority to vote in connection with the election of directors, executive compensation (including say-on-pay), or any other significant matter as determined by the SEC (see Section 957 of the Act).

The New York Stock Exchange (NYSE) has already amended its rules to eliminate broker discretionary voting for the election of directors, independent of whether the election was contested (for details on the amendment of NYSE Rule 452, see Thomas Werlen/Stefan Sulzer, CapLaw-2009-77). Given that NYSE Rule 452 already deems all votes at shareholder meetings of foreign private issuers to be 'non-routine' and because a NYSE broker may therefore not exercise discretionary voting on any agenda item at a foreign private issuer shareholder meeting, the new rules to be adopted by the NYSE will have no impact on foreign private issuers. However, the prohibition affects not only companies listed on the NYSE, but also companies listed on other exchanges, such as NASDAQ.

2) Executive Compensation

a) Compensation Committee Independence

The Dodd-Frank Act directs U.S. stock exchanges to adopt listing standards which require that members of compensation committees be composed exclusively of independent directors (see Section 952 of the Act). The NYSE already requires that the compensation of the Chief Executive Officer be set by an independent compensation committee, and the NASDAQ stock exchange requires that compensation be determined either by a majority of independent directors or an independent compensation committee. However, both exchanges allow a foreign private issuer to follow the corporate governance practices of its home country instead of those prescribed by the listing standards, provided it discloses the ways in which such practices differ from those followed by domestic U.S. companies under the listing standards, a disclosure the SEC also requires. The Dodd-Frank Act follows a similar approach by expressly exempting foreign private issuers from the independent compensation committee requirement as long as they disclose why they do not have such a committee.

b) Responsibilities for Consultants, Legal Counsel and Other Advisors

The Dodd-Frank Act directs stock exchanges to adopt listing standards requiring compensation committees of listed companies to engage consultants, legal counsel and other advisors after taking into consideration the SEC's definition of independence (see Section 952 of the Act). These listing standards will apply to foreign private issuers listed in the U.S., unless the SEC uses its exemptive authority to continue its practice of allowing foreign private issuers to follow the corporate governance practices of their home country, again provided that the differences are disclosed.

c) New Compensation Disclosure

The Act requires that U.S. listed companies provide additional compensation disclosure regarding: (i) the relationship between 'executive compensation actually paid' and the financial performance of the company, 'taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions' (see Section 953 of the Act); and (ii) whether directors and employees are permitted to purchase financial instruments designed to 'hedge or offset any decrease in the market value of equity securities,' whether granted to the director or employee as compensation or held, directly or indirectly, by the director or employee (see Section 955 of the Act). While many companies employ hedging policies with regard to certain key employees, this requirement covers all directors and employees. These additional compensation disclosures will be accomplished through future SEC amendments to the proxy rules. Because foreign private issuers are presently not subject to the proxy rules, these new disclosure requirements will likely not apply to foreign private issuers.

The Dodd-Frank Act also directs the SEC to amend Regulation S-K which lays out reporting requirements for various SEC filings used by public companies. These amendments require companies to disclose the median of the annual total compensation of all employees of the company (other than the chief executive officer) as well as the annual total compensation of the chief executive officer (see Section 953 of the Act). Companies must also provide a ratio comparing those two figures. The Act directs the SEC to amend Item 402 of the Regulation to require this disclosure in any filings 'described in Section 10(a)', which covers not only proxy statements and annual reports on Form 10-K, but also annual reports on Form 20-F submitted by foreign private issuers. It is unclear whether the SEC's final rules will explicitly apply this requirement to foreign private issuers.

d) Say-on-Pay

The Dodd-Frank Act requires U.S. public companies to submit to a non-binding shareholder vote the compensation of executives disclosed in their proxy statements at least once every three years, and the frequency at which such vote shall be required at least once every six years (see Section 951 of the Act). In addition, when soliciting shareholder approval of a proposed acquisition, merger, consolidation or sale of all or substantially all their assets, public companies are now required to disclose information on all golden parachutes that relate to the proposed transaction and to submit those payments that have not already been approved to a non-binding shareholder vote. These provisions impose new requirements concerning the content of proxy statements and therefore are unlikely to apply to foreign private issuers.

e) Clawbacks

The Dodd-Frank Act requires U.S. listed companies to develop and implement policies to recapture (clawback) compensation 'erroneously awarded' to executive officers prior to a restatement of the company's financial statements (see Section 954 of the Act). In the case of a restatement due to material noncompliance with any financial reporting requirement, whether intentional or not, the company must recoup from all present and former executive officers any incentive-based compensation (including stock options) received in excess of what should have been paid according to the company's results after giving effect to the restatement during the three-year period preceding the date on which the issuer is required to prepare the restatement. This requirement is broader than a similar requirement contained in Section 304 of the Sarbanes-Oxley Act of 2002 (available under *http://www.sec.gov/about/laws/soa2002.pdf*) in that it covers all executive officers (rather than only the chief executive officer and the chief financial officer), does not require that the restatement results from misconduct, and calls for a look-back period of three years instead of one year. As is the case with Section 304 of the Sarbanes-Oxley Act, there is no express exemption for foreign private issuers from developing and implementing clawback policies and, unless the SEC adopts an exemption, this provision of the Act will cover all companies listed on a U.S. stock exchange.

We will continue to monitor and report on these new provisions under the Dodd-Frank Act as the legislation evolves.

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Audit Supervision over Foreign Auditing Firms that Provide Auditing Services for Foreign Companies that are Listed at a Swiss Stock Exchange

Reference: CapLaw-2010-55

The foreign auditing firm that provides auditing services for a foreign company that is listed at a stock exchange in Switzerland, will only be subject to article 8 Audit Supervision Act (ASA) when it comes into force. This is not just the case for already listed foreign companies, but also for foreign companies that are to be newly listed. After the abovementioned provision enters into force (at the earliest by mid 2011), the foreign auditing firm will either have to apply for a concession as a government supervised auditing firm in accordance with the ASA or be supervised by a Swiss recognized foreign audit supervision agency.

By Severin Roelli

1) Problem Outline and Statutory Regulation

The ASA states that auditing firms which audit listed companies must be under government supervision (article 7 ASA). For auditing firms that provide auditing services according to foreign law for foreign companies listed in Switzerland, article 8 ASA states an exception: the duty to apply for a concession and to be supervised is waived, if the foreign auditing firm is supervised by a foreign supervision agency that is recognized by the Swiss Federal Council (article 8(2) ASA). A foreign auditing firm will, in this case, only be obliged to register with the Swiss Audit Supervision Authority (SASA) in accordance with article 15 ASA in connection with article 20(j) Audit Supervision Ordinance (ASO).

For the enforcement of the ASA, article 8(3^{bis}) of the Stock Exchange Act (SESTA) requires the stock exchanges to make the admission of equities and bonds dependant on compliance with articles 7 and 8 ASA. Article 13 of the Listing Rules (LR) of the SIX Swiss Exchange (SIX) contains an according provision.

The ASA already entered into force on 1 September 2007. The abovementioned requirements for auditing firms that provide auditing services in accordance with foreign law for foreign companies that are listed in Switzerland are not applicable, because article 8 ASA as well as all the connected provisions (articles 10(1), 13(2), and 20(j) ASO) will enter into force at a later point in time (see article 45 ASA in connection article 52(2) ASO and with the only article of the Decree on the further entering into force of the Audit Supervision Act dated 22 August 2007). The reason why they will enter into force later is that the process of recognition of foreign supervision authorities and the therefore sometimes required negotiations with foreign authorities took longer than expected. The SASA assumes that article 8 ASA will come into force at the earliest middle of 2011 (see also cipher 4.6 progress report SASA 2009, *http://www.revisionsaufsichtsbehoerde.ch/bausteine.net/file/showfile.aspx?downdaid=7542&sp=D&domid=1063&fd=2*).

2) Consequences for Foreign Companies Listed in Switzerland that Obtain Auditing Services from Foreign Auditing Firms.

Even though article 8(3^{bis}) SESTA is in force since 1 September 2007 article 13 LR is not yet enforceable, as article 8 ASA is not yet in force. Also, the delay in entering into force of article 8 ASA cannot lead to the interpretation of article 7 ASA as a general clause that a foreign company that is listed in Switzerland is obliged to choose an auditing firm that is under Swiss supervision until the special rule enters into force. This point of view is confirmed by the Regulatory Board Communiqué of the SIX, no. 10/2007 dated 30 October 2007 regarding implementation of the ASA in the listing formalities in cipher (III)(A)(2): foreign issuers, whose shares are listed at the SIX primarily or secondarily do not need to do anything until the entering into force of article 8 ASA. As soon as the date of the entering into force is determined, the Regulatory Board will inform the affected issuers as well as their auditing firms.

The Regulatory Board does not explicitly mention in its communiqué that the provisional non-application of article 13 LR also extends to foreign companies that are to be newly listed. This must be the case however, as otherwise foreign companies that are to be newly listed would be treated worse than those already listed before the entering into force of the ASA without an objective reason.

After the entering into force of article 8 ASA, foreign auditing firms will only be able to provide auditing services for foreign companies listed in Switzerland if they are recognized as a government supervised auditing firm in accordance with the ASA or are supervised by a foreign audit supervision authority that is recognized by Switzerland. The entering into force of article 8 ASA will coincide with transitional provisions, so that the necessary registrations can be done.

For the sake of completeness it is to be noted, that the abovementioned does not apply to foreign auditing firms that provide auditing services to Swiss listed companies in accordance with Swiss law. Such auditing firms are in any case and already since the entering into force of the ASA under the supervision of the SASA (article 10(2) ASO).

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Mandatory Clearing of Derivatives in the U.S. under the New Dodd-Frank Wall Street Reform and Consumer Protection Act

Reference: CapLaw-2010-56

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or the Act) which was signed into law on 21 July 2010 requires that certain derivative instruments be cleared through regulated clearing organizations and traded on a trading platform. This article describes the most important aspects of the mandatory clearing under the new act.

By Stefan Kramer

1) Introduction and Background

Risks built up in (bilateral) markets for credit default swaps and other over-the-counter (OTC) derivatives are widely considered to have significantly contributed to the current financial crisis. Systemic risk concerns led to calls for a revision of the regulatory framework and the organization of derivatives markets in various countries (see Werlen/Sulzer in: CapLaw-2010-47). In the United States (U.S.), the Dodd-Frank Act (available under *http://docs.house.gov/rules/finserv/111_hr4173_finsrvcr.pdf*) was signed into law by President Obama on 21 July 2010. It imposes a comprehensive and restrictive regulatory regime on the markets for derivative instruments and the market participants. One of the most significant changes is the requirement that certain derivative instruments be cleared through regulated clearing organizations.

A clearing organization (also referred to as clearinghouse or central counterparty) is a separate legal entity that steps between the buyer and the seller of a financial instrument and assumes the rights and obligations of both parties to the trade. A clearing organization typically seeks to protect its members from a default by another member by collecting upfront and mark-to-market margin on each transaction and/or contributions to a guarantee fund from its members. Interposing a clearing organization as counterparty to a large part or all of the trades in OTC derivatives is intended to mitigate the risk of a chain reaction (*i.e.*, the subsequent failure of other market participants) in the event a major player in the derivatives market defaults. In addition, in order to provide transparency to the regulators and the market, the Dodd-Frank Act requires that derivative instruments subject to the clearing requirement be traded on an exchange or similar trading facility.

2) Instruments Subject to the Clearing Requirement

Subject to certain exceptions (see below at 4. 'Exemptions from the Clearing Requirement'), the Dodd-Frank Act requires swaps and security-based swaps to be centrally cleared if they are accepted for clearing by a derivatives clearing organization and are of a type that the U.S. Commodity Futures Trading Commission (CFTC) or the U.S. Securities and Exchange Commission (SEC) determines are subject to the clearing requirement.

Swap is broadly defined to include most types of OTC derivatives, subject to a carve-out for security-based swaps and certain other specified exceptions. The definition lists, *inter alia*, a number of specific instruments such as puts, calls, caps, floors, collars, and similar options on currencies, commodities, securities, or indices, as well as transactions commonly known as interest rate swap, currency swap, foreign exchange swap, total return swap, credit default swap. In addition, the definition includes a broad catch-all category referring to any 'agreement, contract or transaction that is or in the future becomes commonly known to the trade as a swap' (Section 721 of the Act). Foreign exchange swaps and foreign exchange forwards will be considered swaps unless the Department of the Treasury makes a written determination that they should not be regulated as swaps under the Dodd-Frank Act and are not structured to evade the act in violation of any rule promulgated by the CFTC thereunder. In contrast, the term swap does not include any contract of sale of a commodity for future delivery or any sale of a nonfinancial commodity or security for deferred delivery, so long as the transaction is intended to be physically settled.

Security-based swap means any instrument that is a swap and is based on an index that is a narrow-based security index, a single security or loan, or the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index (Section 761 of the Act).

3) Determination of Instruments Subject to the Clearing Requirement

Under the Dodd-Frank Act, the CFTC and the SEC are assigned the gate-keeping role in determining which swaps and security-based swaps, respectively, are subject to the clearing requirement. In making this decision, the CFTC (in the case of swaps) an the SEC (in the case of security-based swaps), must take into account the following factors: (i) the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data, (ii) the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract, (iii) the effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract, (vi) the effect on competition, including appropriate fees and charges applied to clearing, and (v) the existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or one or more of its clearing members (Sections 723 and 763 of the Act). One of the major obstacles for central clearing is the lack of standardization of many OTC derivatives (*e.g.*, certain types of credit default swaps). Although there is no conclusive data available on this point, it is believed that a significant portion of the OTC derivatives market is likely to remain bilaterally cleared and settled for the foreseeable future.

The regulatory review process for a particular category of swap or security-based swaps may be initiated by a clearing organization or by the competent regulator. To the extent the CFTC or the SEC, as applicable, finds that a particular swap or security-based swap would otherwise be subject to mandatory clearing but is not accepted for clearing by any derivatives clearing organization, the relevant regulator will investigate the relevant facts and circumstances and take such actions as the CFTC or the SEC, as applicable, determines to be necessary and in the public interest. The actions of the competent regulator may include requiring the retaining of adequate margin or capital by parties to the swap, provided, however, that the regulators may not require a derivatives clearing organization to accept for clearing a particular swap if this would threaten the financial integrity of the derivatives clearing organization (Sections 723 and 763 of the Act). Any designated clearing organization, swap dealer, or major swap participant that knowingly or recklessly evades or participates in an evasion of the clearing requirement may be held liable for a money penalty (Section 741 of the Act).

The Dodd-Frank Act also provides incentives to dealers and other market participants to structure derivative instruments in a way that allows for them to be centrally cleared. In particular, a publicly traded corporation that wishes to rely on the end user exemption (see below at 4. 'Exemptions from the Clearing Requirement') is only allowed to do so if an appropriate committee of the issuer's board or governing body has reviewed and approved its decision to enter into swaps or security-based swaps that are subject to such exemptions. Furthermore, in setting capital requirements and margin requirements for a swap dealer or a major swap participant, the competent prudential regulator as well as the CFTC or the SEC, as applicable, must take into account the risks associated with the types of swaps or security-based swaps engaged in. With respect to the use of swaps or security-based swaps that are not subject to the clearing requirement, the act provides that, in order to offset the greater risk arising from non-cleared instruments, the capital requirements imposed on swap dealers and major swap participants shall help ensure the safety and soundness of the swap dealer or major swap participant and be appropriate for the risk associated with the non-cleared instruments (Sections 731 and 764 of the Act).

4) Exemptions from the Clearing Requirement

A swap or security-based swap can be exempt from the clearing (and the exchange trading) requirement if one of the counterparties to the transaction is an end user that is using the instrument to hedge or mitigate its own commercial risk. The application of the exemption is, however, solely at the discretion of the counterparty to the transaction that is an end user. The so called ***end user exemption*** applies only to a counterparty that is not a financial entity, is using swaps or security-based swaps to hedge or mitigate commercial risk, and notifies the CFTC or SEC how it generally meets its financial obligations associated with entering into non-cleared instruments (Sections 723 and 763 of the Act). The CFTC or the SEC, as applicable, shall consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions. The term financial entity does not include captive finance companies that meet certain requirements.

An ***affiliate*** of a person that qualifies for the end user exemption may, subject to certain exemptions, rely on the end user exemption if that affiliate, acting on behalf of the end user, uses the swap or security-based swap to hedge or mitigate the commercial risk of the end user (Sections 723 and 763 of the Act).

The Dodd-Frank Act does not contain an express rule as to whether or not end users who are given the option to enter into non-cleared swaps or security-based swaps will be exempt from the capital and margin requirements that are imposed on counterparties to non-cleared swaps and security-based swaps. However, on 30 June 2010, Senators Dodd and Lincoln released a letter addressed to Representatives Frank and Peterson clarifying that the legislation was not intended to authorize the regulators to impose margin or capital requirements on end users. Non-cleared swaps and security-based swaps are, however, subject to certain reporting and recordkeeping requirements.

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Adobe Takeover Offer for Day Software Holding AG

Reference: CapLaw-2010-57

On 28 July 2010, Adobe Systems Benelux B.V. pre-announced a public exchange offer for all publicly held shares of Day Software Holding AG, Basel. By decision of 20 August 2010, the Takeover Board declared the terms of the offer to be in compliance with statutory takeover provisions. The offer was published on 23 August 2010. Shareholders will receive CHF 139 for each share tendered, this represents a premium of 59 percent over Day's volume-weighted average share price for the last 60 trading days of CHF 87.30. The offer period opened on 7 September 2010 and should end on 4 October 2010, Adobe, however, reserved the right to extend the offer period.

Federal Penal Tribunal Acquitted Vekselberg, Pecik and Stumpf

Reference: CapLaw-2010-58

With decision of 21 September 2010, the criminal division of the federal penal tribunal acquitted Vekselberg, Pecik, Stumpf and Stadelhofer of the charges of violation of the Stock Exchange Act (SESTA) in connection with OC Oerlikon. The detailed reasoning is to follow later.

The criminal division concluded that the charges of the federal department of finance (FDF), that Victory Industriebeteiligungen AG (controlled by Pecik and Stumpf) and a company of the Renova Group (controlled by Vekselberg) acted in concert in the sense of SESTA concerning OC Oerlikon Corporation AG, remained unproven. The circumstances raised by the FDF as circumstantial evidence can be explained as normal business behavior without having to refer to secret agreements between these shareholders. The charges of the prosecution did not only remain unproven, they also lack plausibility as no purpose to the secret agreements was ascertained.

St. Gallen Stock Company Law Forum 2010 (St. Galler Aktienrechtsforum 2010)

Friday, 29 October 2010
SIX ConventionPoint, Zurich www.eiz.uzh.ch

University of St. Gallen and Swiss Funds Association, *irp@unisg.ch*
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Too Big to Fail—Brauchen wir ein Sonderinsolvenzrecht für Banken? Do we need Special Rules for Bank Resolution?

Friday, 5 November 2010
Goethe-Universität Frankfurt am Main, Campus Westend, Grüneburgplatz 1, 60323 Frankfurt am Main

Institute for Law and Finance (Goethe-Universität Frankfurt a.M.)
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Capital Market Transactions VI

Thursday, 25 November 2010
Kongresshaus, Zurich

Europa Institute at the University of Zurich, *eiz@eiz.uzh.ch*
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Developments in Collective Investment Schemes Legislation V (Entwicklungen im Recht der kollektiven Kapitalanlagen V)

Tuesday, 7 December 2010
SIX ConventionPoint, Zurich

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