

NEWSLETTER

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The modification of the provision on international administrative assistance in the Federal Law on Stock Markets and Securities Dealing

On 1st February 2006 the revision of article 38 of the Federal Law on Stock Markets and Securities Dealing ("LBVM") came into effect. This law, which concerns international administrative assistance, was modified so as considerably to facilitate the administrative assistance that Switzerland can grant to other states in the framework of the application of regulations on stock markets and securities dealing. In particular, in its new wording, the law to a large extent eliminates what is known as the "long arm principle".

1 The reasons for a request for administrative assistance addressed to Switzerland.

As a rule, a request for international administrative assistance originates from a foreign **financial markets supervisory entity** in charge of an administrative investigation in the state concerned. When an active participant on a foreign market uses a Swiss bank or a Swiss securities dealer as an intermediary for conducting stock market transactions, suspicions may arise in the state concerned which justify Switzerland's transmitting information to the competent authorities of that state.

If, as often happens, the offence concerned is **insider trading**, it is usually the prior transmission of confidential information likely to influence market prices that is the event of interest to the authority in charge of the administrative investigation in the requesting state. The Swiss Federal Tribunal (Supreme Court) retains that, to form the grounds of a first suspicion concerning an offence of insider trading, it is sufficient for the operations to have been conducted immediately before the publication of information likely to influence market prices. It is therefore not necessary for the price of the shares concerned to have moved in a certain way at the time they were purchased, or immediately afterwards, or for the suspicions concerning market price variations to have been confirmed when the investigation is opened. In such circumstances, the authority in charge of the administrative investigation usually needs information about the doubtful transaction, particularly regarding the identity of the people who took part in it.

In Switzerland, the administrative authority in charge of assistance to foreign market supervisory authorities is the

Federal Banking Commission ("CFB"). However, this situation is provisional because, in early 2006, the Federal Council approved a draft law aimed at reorganising the supervision of financial markets in Switzerland. Among the important modifications envisaged – which should not come into effect before 2008 – is the introduction of a new financial markets supervisory body to be called the Federal Financial Markets Supervisory Authority ("FINMA").

2 The international administrative assistance proceeding

When the CFB receives a request for administrative assistance from another state, it first makes sure that certain strict conditions are fulfilled. In particular, this involves ascertaining that the foreign authority issuing the request is indeed competent as regards the supervision of financial markets in the state concerned.

Having made sure that these strict conditions are fulfilled, the CFB opens an administrative mutual assistance proceeding and will then do what is necessary to collect the information and documents required by the requesting state.

The CFB then examines the information the banking institutions and/or securities dealers have transmitted and, if it considers that the conditions for embarking on the proceeding and supplying the required administrative assistance are all fulfilled, it then issues a notification by means of a formal decision.

The parties affected by the decision will then learn of the existence of the investigation being conducted in the state concerned. As a rule, the information required from Switzerland includes data enabling the client or clients concerned by the suspect transaction to be **identified**, as well as the circumstances in which the transaction was carried out, giving details of the stock market operations involved in it.

Until now, and in contrast to established court practice as regards international mutual assistance in criminal matters, international administrative assistance granted by Switzerland was more limited, in that any information not **directly related**



to the doubtful transactions identified in the request for mutual assistance was not transmitted.

An appeal can be lodged with the Federal Tribunal against the decision by means of which the CFB orders information to be transmitted to the requesting authority. Such an appeal can be lodged by the client of the bank or of the securities dealer whose identity is disclosed. In fact, that person has the status of a party to the assistance proceeding. Until the revision of article 38 LBVM came into effect, the time limit for lodging an appeal to the Federal Tribunal was **30 days**. As indicated below, that time limit is now reduced to 10 days, so as to speed up administrative assistance proceedings.

3 The innovations introduced by the revision of article 38 LBVM

3.1 The reasons for the revision of article 38 LBVM

According to the CFB's statistics, the number of requests for administrative assistance presented to Switzerland is increasing year by year.

In its version prior to the one that came into effect on 1st February 2006, article 38 LBVM stipulated certain conditions concerning confidentiality which had led the Swiss Federal Tribunal to suspend administrative assistance between the CFB and the American stock market supervisory authority (the *Securities and Exchange Commission*, "SEC"). In fact, according to the procedural law applicable in the United States, the complaints proceeding and the documentation concerning it are accessible to the public. Hence, the SEC disseminates information in the media and particularly on its website (*litigation releases*). The Federal Tribunal also suspended administrative assistance with the United States because of doubts that arose about observance of the principle of speciality by the SEC. This rule essentially states that information or evidence transmitted pursuant to a request for assistance may only be used for the purpose for which it is provided. While the SEC had in fact declared that it would request the CFB's prior approval before any subsequent release of information and evidence to another authority, the SEC had nevertheless reserved the right to release information without seeking prior authorization where such a request was found to be impossible or prohibited, or where time was of the essence.

3.2 Abandonment of the "long arm" principle and partial abandonment of the dual criminal liability principle

Prior to 1st February 2006, article 38, sub-paragraph 2 (c), LBVM envisaged that the CFB could only send foreign supervisory authorities information and documents not accessible to the public if such information and evidence would not, in turn, be released to other authorities without the prior approval of the CFB (the so-called "**long arm**" principle).

Now that the revision of article 38 LBVM has come into effect, that provision has been purely and simply **deleted**.

Thus, before the revision of the law, a complete assistance proceeding in Switzerland needing two decisions by the Swiss

Federal Tribunal (that is to say, a first decision on the transmission to the requesting authority and a second decision regarding retransmission to another authority) could last up to three years. That was one of the chief arguments raised in favour of the revision of article 38 LBVM.

Moreover, the rule set out in article 38, sub-paragraph 2 (c), LBVM, according to which no information could be sent to criminal authorities when mutual judicial assistance was excluded, implied an examination of the request for mutual assistance from the point of view of the **principle of dual criminality**. Pursuant to this rule, the requesting administrative authority could only retransmit information to a criminal authority if the offence concerned was prosecutable in both the country of the requesting authority and in Switzerland.

Because the principle of dual criminality could not easily be met by foreign requesting authorities, the Federal Council was of the view that it needed to be revised. In particular, the offence of insider trading has caused severe difficulties in this context, in that the scope of Article 161 of the Federal Penal Code ("CP"), which penalises the offence of insider trading, is particularly narrow, and the Federal Tribunal makes a restrictive interpretation of what confidential information, knowledge of which is exploited in order to gain a financial benefit, is likely to influence stock market prices.

Although article 161 CP will most likely undergo substantial modifications in the framework of the implementation of the revised recommendations of the Financial Action Task Force on Money Laundering ("FATF"), the Swiss legislator considered that the legal framework regarding administrative assistance should be modified without delay, which is why the revision of article 38 LBVM came into effect as early as 1st February 2006.

In its message of 10th November 2004, the Federal Council justified abandoning the principle of dual criminality, with regard to offences committed on financial markets, by the fact that the only relationship maintained with Switzerland by the client in question is, in principle, a banking relationship, and because there cannot be any meaningful investigation in the requesting state without disclosing the client's name. Thus, the requirement of dual criminality is no longer applicable when the information requested is forwarded to other authorities for the purpose of enforcing **regulations on stock markets and securities dealing**. By contrast, the rule is maintained when information is retransmitted in order to prosecute other types of offences unrelated to regulations on stock markets and securities dealing such as fraud, for example.

Lastly, according to the Federal Council's message, the old wording of article 38 LBVM was not compatible with the international directives issued by entities such as the International Organisation of Securities Commissions ("IOSCO") and European regulations (particularly Directive 2003/6/CE of the European Parliament and the EU Council of 28th January 2003 on insider dealing and market manipulations).

With the disappearance of article 38, sub-paragraph 2 (c), LBVM, Switzerland thus abandoned the long arm principle,

and (partly) the principle of dual criminality, but reserved the right to apply the **speciality principle**. That principle prohibits the requesting state from using the documents and information supplied in the framework of mutual assistance for purposes other than the repression of the offences for which the requested state had granted its cooperation. In fact, article 38, sub-paragraph 6, LBVM envisages that, in agreement with the Federal Office of Justice, the CFB can authorise the retransmission of the information to criminal authorities for purposes other than implementing the regulations on stock markets and securities dealing, provided that mutual judicial assistance in criminal matters is not excluded. In other words, the retransmission of information for tax purposes remains prohibited.

3.3 The principle of confidentiality

The principle of confidentiality envisages that information can be transmitted to the requesting authorities only if those authorities are bound by professional secrecy. The revision of article 38 LBVM now in force clearly makes the principle of confidentiality **more flexible**, as henceforth the law envisages that the requesting state's provisions on public announcement of proceedings and public information about those proceedings are reserved. This modification of the law allows to now grant administrative assistance to the United States, which in the past, was blocked because of the above-mentioned litigation releases required pursuant to local U.S. procedural law.

It is interesting to note that, when the authorities concerned in Switzerland were consulted before the draft revision of article 38 LBVM was set up, the Federal Data Protection Commissioner opposed the proposal aimed at making the confidentiality principle more flexible. Basing his opinion on the practice of the SEC, he stated that the protection of the identity of the clients of the banks concerned was not assured in the framework of administrative assistance, in that the SEC would not adopt similar measures in that respect. In the opinion of the Data Protection Commissioner, the SEC's publication on the Internet of personal information obtained in the framework of administrative assistance constituted a serious threat, as the information in question ought to be considered sensitive in the sense of Swiss law. The Federal Council rejected those objections with arguments which, in our opinion, were not wholly convincing. According to the government, the public would not be informed that a complaint had been lodged in the United States until suspicions had been confirmed in the framework of an internal procedure. However, no explanation is given about the type of procedure and the means of defence made available to the person concerned by the SEC's investigation. The CFB further indicated that it knows of no case in which the SEC had published any information about Swiss bank accounts or the Swiss source of the information in question, apart from the names of the clients. Again, this purely empirical observation does not mean that one day the SEC might not modify its practice and start to do so.

3.4 The proportionality principle

The new sub-paragraph 4 of article 38 LBVM now expressly states that the CFB must adhere to the proportionality principle.

The proportionality principle, which is constitutional in nature, requires state intervention to be limited to what is adequate and necessary to achieve the aim being pursued by a coercive measure. In the framework of international mutual assistance in criminal matters, this principle implies that the requested state should limit its intervention to the needs of the requesting state described in the request for mutual assistance. In particular, this principle is reflected in the necessity for the executing authority to sort the documents it considers useful for the foreign proceeding. On several occasions, the Federal Tribunal has confirmed that the authority executing a request for assistance cannot release itself by sending the requesting state all documents seized in Switzerland "in bulk". However, it should be noted that court practice has lessened the effect of the proportionality principle, considering that international cooperation can be refused only if the items called for have no connection with the offence being prosecuted and are clearly not of a nature to help advance the foreign investigation, making the request look like an excuse for an undefined search for evidence (*fishing expedition*).

The proportionality principle does not oblige the CFB itself to examine the facts described in the request for international administrative assistance. In particular, the CFB does not have to analyse the transaction which is the origin of the request for administrative assistance. It is the task of the requesting authority alone to decide whether or not a transaction is suspicious.

Lastly, it results from the proportionality principle, as it was already being applied before 1st February 2006, that the transmission of information regarding persons not involved in the matter under investigation in the requesting state must be **excluded**. This principle is maintained, in the sense that the CFB does not transmit the name of a client when that client claims that the disputed transaction was conducted not by himself but unknown to him and without the help by a third party (e.g. the asset manager). In such cases, the CFB will not transmit the identity of the client if the client's explanations do not give rise to any doubt.

3.5 Limitation of the right to lodge an appeal and acceleration of the appeal procedure

In a decision of July 2002 regarding a case of international mutual assistance in criminal matters, the Swiss Federal Tribunal held that a bank did not have the capacity to act when, without being affected in the conduct of its own business, it was asked simply to remit documents concerning its clients' accounts and/or, through the intermediary of its employees, to supply additional explanations about those documents. It therefore results from that decision that, unless a bank was conducting operations for its own account and was thus personally affected **in the conduct of its own business**, only the client concerned by the request for mutual assistance whose account was the subject of an order to transmit information is qualified to appeal against that order.

Henceforth, that principle will be applied in cases of administrative assistance, and the bank or stockbroker will not be able to appeal against the CFB's decision to transmit information to



a foreign authority unless that bank, or respectively that stockbroker, is personally affected in the conduct of its or his own business.

Moreover, the time limit for lodging an appeal with the Federal Tribunal against the CFB's decision which grants administrative assistance has been reduced from 30 to **10 days**. This is an absolute time limit. That is to say, it cannot be suspended or extended.

4 Final observations

The aim of the revision of article 38 LBVM is to encourage and facilitate the international administrative assistance that Switzerland undertakes to grant to other states. This legislative modification is a continuation of the course Switzerland has followed in recent years, illustrated by a progressive renunciation of mechanisms that help limit the transmission to foreign countries of information essentially affecting the Swiss financial sector and banking secrecy in particular.

Paradoxically, the reasons given to justify these **new limitations on banking secrecy** are based on the maintenance or even strengthening of the Swiss financial market place. In fact, the Swiss authorities must try to find compromises to enable the special features of the Swiss financial market place to be preserved and the mechanisms of international cooperation to be improved at the same time. Thus, in its message of November 2004 supporting the revision of article 38 LBVM, the Federal Council points out risks concerning the potential restrictions that foreign authorities could impose on Swiss banks and stockbrokers regarding access to their stock markets. The risks linked to an absence of reciprocity which could lead foreign stock market supervisory authorities to cease granting administrative assistance to Switzerland are also mentioned.

The Federal Council is not hiding the fact that the revision of article 38 LBVM will finally make it possible to silence certain criticisms originating from abroad about Switzerland's alleged permissiveness regarding market abuses. This is at the heart of the debate, that is to say, Switzerland's reaction to the international pressures confronting it while preserving an efficient and competitive financial market place. Having taken note of these observations, the financial participants who are likely to be concerned by this new regulation will need to assess its full scope.

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The content of this newsletter cannot be assimilated with legal or tax advice. If you would like advice about your individual situation, your usual contact at Schellenberg Wittmer or one of the following lawyers will gladly answer your questions:

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