Equity Derivatives 2021

Contributing editor
Rafal Gawlowski

LEXOLOGY®
Getting The Deal Through

Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
Claire Bagnall
claire.bagnall@lbresearch.com

Senior business development manager
Adam Sargent
adam.sargent@gettingthedealthrough.com

Published by
Law Business Research Ltd
Meridian House, 34-35 Farringdon Street
London, EC4A 4HL, UK

First published 2016
Sixth edition
ISBN 978-1-83862-657-0

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

Equity Derivatives 2021

Contributing editor
Rafal Gawlowski
Latham & Watkins LLP

Lexology Getting The Deal Through is delighted to publish the sixth edition of *Equity Derivatives*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Rafal Gawlowski of Latham & Watkins LLP, for his continued assistance with this volume.

LEXOLOGY
Getting The Deal Through

London
June 2021

Contents

Switzerland

Olivier Favre and Tarek Houdrouge

Schellenberg Wittmer

OVERVIEW

Typical types of transactions

1 Other than transactions between dealers, what are the most typical types of over-the-counter (OTC) equity derivatives transactions and what are the common uses of these transactions?

Equity derivatives transactions in the form of OTC derivatives transactions are used in the Swiss market in particular as follows:

- to hedge a long position in a shareholding (eg, by purchasing a put option in the underlying shares). Such derivatives may combine a put and a call option in one transaction (eg, as a collar transaction), allowing the purchaser of the put option to benefit from a lower premium or reducing the premium to zero (eg, in the event of a zero cost collar). They may also be traded as a variable forward transaction;
- to build a long position in the underlying shares (eg, through equity swaps or call options) without purchasing the underlying shares;
- in the context of margin lending (eg, by entering into a prepaid forward combined with an equity swap), where the economics of the transaction are a loan secured by the underlying shares;
- as a hedge to establish a short position (eg, by entering into a short position under an equity swap) as an alternative to a short sale; and
- as part of a capital markets transaction (eg, option of issuer to receive additional shares in the context of a listing of shares in view of stabilising the price).

Borrowing and selling shares

2 May market participants borrow shares and sell them short in the local market? If so, what rules govern short selling?

A short sale by borrowing shares and selling them on the market in view of an expected decrease of the market price is a widely used way of entering into a short position. Short selling is not subject to specific limitations under Swiss law in terms of maximum positions that may be entered into. Short sales are, however, subject to the following.

Shareholder disclosure requirements

The Swiss rules regarding the disclosure of shareholdings pursuant to article 120 of the Swiss Financial Market Infrastructure Act (FMIA) provide that any shareholder of a company listed at the SIX Swiss Exchange or BX Swiss crossing a relevant threshold (either by exceeding or falling below a relevant threshold) must disclose and report such shareholding to the listed company itself as well as to the exchange. The disclosure is then published by the exchange. The relevant thresholds are 3, 5, 10, 15, 20, 25, 33⅓, 50 and 66⅔ per cent and the shareholdings are calculated by reference to the voting rights represented by the shares in such listed company.

A disclosure must be made as soon as an investor reaches or exceeds one of the thresholds with either its long position in the shares (physical shareholding aggregated with any rights to receive delivery of shares and any other long positions in respect of the shares, eg, arising from a derivatives transaction) or its short positions entered into in respect of the shares (eg, obligations to deliver shares or any short positions arising from a derivatives transaction). For the purposes of this calculation, the long and short positions must not be netted. Where an investor holds both a long position arising from the purchase of shares and at the same time a short position, a separate calculation for such long and short positions must be made. A disclosure must also be made as soon as the investor falls again below any of the thresholds with its long or short positions.

The disclosure obligation is triggered as a result of entering into any agreement giving rise to the long or short positions in the shares that must be disclosed. The disclosure must then be made by the end of the fourth trading day after such date.

Where a threshold is crossed upwards and downwards during the same trading day, this would not trigger a disclosure obligation.

As regards short sales, the borrowed shares are taken into account for the calculation of the long position of the shares. The borrower is subject to a disclosure obligation to the extent that a threshold is crossed with the number of borrowed shares (subject to an exemption applicable to banks and securities dealers for borrowed shares up to 5 per cent). The borrower would not have a disclosure obligation, where the loaned shares are on-sold intra-day (ie, on the same day the disclosure of the stock loan was triggered). To the extent that the intra-day exemption does not apply and the borrower sells the loaned shares to third parties during the term of the loan, the borrower must, in addition to the initial disclosure as a result of entering into the stock loan, make a further disclosure in the event that the borrower crosses downward a threshold as a result of the on-sale. When the short position is closed, the same disclosure obligations apply in reverse order (if crossing upward a threshold with the purchase on the market and then crossing downward a threshold by returning the borrowed shares to the lender subject the intra-day exemption).

Mandatory takeover offers

Whoever acquires, directly, indirectly or acting in concert with third parties, equity securities that, in addition to equity securities already owned, exceed the threshold of 33⅓ per cent of the voting rights of a target company (calculated on the basis of the total number of voting rights registered in the commercial register) must make an offer to acquire all listed equity securities of that company. As regards the calculation of the positions to be taken into account for the obligation to make a mandatory takeover offer, only rights in shares conferring voting rights should – as a general rule – be counted. To the extent that borrowed shares may be counted against the threshold would therefore primarily depend on whether any voting rights in respect of the shares

may be exercised. This should be analysed and, if necessary, discussed with the Swiss Takeover Board on a case-by-case basis.

Insider dealing and market abuse

On the basis that the shares are listed on the SIX Swiss Exchange or BX Swiss, any party involved in the short sale should be mindful whether it may have at any time knowledge of 'material non-public information' in the sense of the Swiss market abuse legislation and how this would be relevant for it. Under the rules of the Swiss insider dealing and market abuse legislation, any non-public information that would have a material effect on the price of shares admitted to trading on a trading venue in Switzerland, if it were made public, would be classified as 'material non-public information'.

Requirements regarding the transfer of title in shares

The requirement for the transfer of title in Swiss shares depends on the type of shares. Assuming the shares are admitted to trading on a trading venue, they are issued in the form of intermediated securities held through a custodian according to the rules of the Swiss Federal Intermediated Securities Act (FISA). However, if the shares are registered shares with transfer restrictions (*vinkulierte Namenaktien*), the transfer of title would not be completed with the debits and credits of the shares in the custody accounts. A transfer of shares that does not occur on the basis of a trade on the trading venue must be notified to the issuer in view of a registration of the transferee in the shareholders' register to complete the transfer as regards any interaction with the issuer (eg, for the purposes of exercising voting rights). As long as such notification has not occurred, a transferee may receive dividend payments through the custody chain, but he or she may not exercise voting rights.

Applicable laws and regulations for dealers

3 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between dealers. What regulatory authorities are primarily responsible for administering those rules?

OTC derivatives fall into the scope of the regulatory obligations applicable to derivatives transactions according to article 93 et seq. of the FMIA, including obligations to comply with reporting obligations, risk mitigation obligations and bilateral margin requirements for uncleared transactions (the FMIA Obligations). At present, the FMIA Obligations do not include a clearing obligation for equity derivatives transactions, but for other types of OTC derivatives transactions (certain types of interest rate derivatives and some credit derivatives on indices). While the FMIA provides for the statutory basis to implement a venue trading obligation, the Swiss Federal Council has so far not implemented such obligation.

The FMIA Obligations are, to a certain extent, aligned with those of the EU according to the European Market Infrastructure Regulation (Regulation (EU) No 648/2012; EMIR).

The FMIA Obligations do not include any licensing or registration requirements. However, the Swiss Financial Market Supervisory Authority (FINMA) is the competent regulatory authority in charge of interpreting and administering these rules, to the extent that the FMIA and its implementing ordinance give FINMA a competence to that effect.

The scope of the FMIA Obligations depends on the classification of the trading counterparties as a large financial counterparty (FC+), small financial counterparty (FC–), large non-financial counterparty (NFC+) or small non-financial counterparty (NFC–). Dealers (assuming they are regulated as a bank or investment firm) fall into the category of FCs. They are an FC+ if they cross the threshold of 8 billion Swiss francs in outstanding gross notional amounts of OTC derivatives across all asset classes in the aggregate (counting also hedging transactions, but excluding OTC derivatives that are not subject to the FMIA Obligations, such as physically settled commodity derivatives not traded on a trading venue or on an organised trading facility and excluding physically settled FX forwards and physically settled FX swaps). The calculation must be made on a group-wide basis by aggregating the positions of all FCs in the group (but excluding funds and collective investment schemes in the group). It is made on an average of 30 business days (ie, looking back for 30 business days and taking the average position as of the day the calculation is made). If dealers do not qualify as FC+, they are FC–.

Trades between dealers fall into the scope of the reporting obligation. However, the reporting obligation is one-sided and it falls on the Swiss dealer that is an FC+ if it deals with a Swiss FC–. For a trading relationship between two Swiss FC+, the seller reports and, if it is not clear who the seller is, the ISDA tie-breaker rules are used to determine the reporting party. If a Swiss dealer trades with a foreign counterparty, the reporting obligation falls on the Swiss dealer.

Except where they are cleared with a FINMA-recognised central counterparty, trades between dealers qualifying as FCs are subject to risk mitigation obligations and margin requirements. As under EMIR, the risk mitigation obligations comprise an obligation to exchange trade confirmations on a timely basis, to agree portfolio reconciliation and dispute resolution (PRDR) clauses (eg, by entering into an FMIA Agreement as published by the Swiss Bankers Association) and perform the portfolio reconciliation, to do periodic portfolio compressions and to exchange valuations.

The margin requirements are aligned with EMIR and include an obligation to exchange variation margin and – to the extent that the average aggregated notional amounts (AANA) of the dealers exceed 8 billion Swiss francs – initial margin.

The phase-in of the obligation to exchange initial margin was aligned with the commitments at the global level. By 1 September 2021, the obligation to exchange initial margin enters into force for parties exceeding 50 billion Swiss francs in AANA and parties exceeding 8 billion in AANA will become subject to the obligation to exchange initial margin by 1 September 2022. To the extent that the parties do not cross the threshold of 50 million Swiss francs in initial margin to be exchanged, the obligation does not apply. However, the parties are responsible for putting in place the relevant documentation ahead of crossing the 50 million Swiss francs threshold for the first time.

For options on single shares, share baskets or equity index options, the obligation to exchange variation and initial margin has been postponed until 1 January 2024.

FINMA recognised the regulation under EMIR and under UK EMIR as equivalent for the purposes of complying with the risk mitigation and margin requirements. A Swiss party falling into the scope of these FMIA Obligations is therefore free to comply with these requirements by applying EMIR or UK EMIR on a substituted compliance basis. As regards the margin requirements, this also applies to the CFTC margin rules under US law.

Entities

4 In addition to dealers, what types of entities may enter into OTC equity derivatives transactions?

Swiss regulations do not limit the counterparties to OTC equity derivatives transactions. Therefore, such transactions may be entered into with any type of entity as counterparty.

However, some regulated Swiss entities (such as insurance companies, pension funds and collective investment schemes) are subject to certain regulatory requirements for their investments (eg, diversification rules) and must also comply with these rules when entering into equity derivatives.

In addition, the parties to the OTC equity derivatives must comply with the FMIA Obligations.

Applicable laws and regulations for eligible counterparties

5 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer? What regulatory authorities are primarily responsible for administering those rules?

Where the counterparty is regulated as a collective investment scheme, a fund manager, an asset manager of a collective investment scheme, an insurance company, a reinsurance company, a pension fund or an investment trust of a pension fund, the counterparty would be an FC and the scope of the FMIA Obligations would be same as for dealers. Other parties are NFCs, as long as they are an 'undertaking' registered with the Swiss Commercial Register or set up as a legal entity, trust or similar undertaking.

An NFC would be deemed to be a large NFC if it crosses at least one of the following thresholds with its outstanding gross notional amounts of OTC derivatives:

- 1.1 billion Swiss francs for equity derivatives;
- 1.1 billion Swiss francs for credit derivatives;
- 3.3 billion Swiss francs for interest rate derivatives;
- 3.3 billion Swiss francs for FX derivatives; or
- 3.3 billion Swiss francs for commodity and other derivatives.

Such calculations exclude hedging transactions, OTC derivatives that are not subject to the FMIA Obligations (such as physically settled commodity derivatives not traded on a trading venue or on an organised trading facility) and physically settled FX forwards and physically settled FX swaps. However, the calculation must be made on a group-wide basis by aggregating the positions of all NFCs in the group. It is made on an average of 30 business days (ie, looking back for 30 business days and taking the average position as of the day the calculation is made). Given the exclusions, NFCs only rarely cross the NFC+ threshold.

Where the counterparty is an NFC–, the margin requirements do not apply. Also, the clearing obligation does not apply in respect of derivatives that would be in scope (eg, certain categories of interest rate derivatives).

The reporting obligation applies, except for trades between two NFC–. However, on the basis of the one-sided nature of the reporting obligation, the reporting obligation falls on a Swiss FC or NFC+ if it trades with an NFC–. It only falls on an NFC– to the extent that the counterparty is not incorporated in Switzerland (eg, a non-Swiss dealer). The go-live date of such obligation for NFC– has been postponed to 1 January 2024.

The risk mitigation obligations must also be taken into account for trades with an NFC–. Therefore, the trading documentation entered into with NFCs must also include the PRDR wording (eg, by entering into an FMIA Agreement as published by the Swiss Bankers Association) and the transactions must be documented in trade confirmations that are exchanged on a timely basis. However, if the counterparty is an NFC–, the parties must not perform the portfolio reconciliation.

In addition to the above, to the extent that the transaction is entered into by a financial services provider with a Swiss client as counterparty, the financial services provider must comply with rules of conduct as resulting from the Swiss Financial Services Act (FinSA). Such rules apply to the extent that the transaction is entered into in the context of a client relationship with the trade counterparty, irrespective of whether the trade is entered into on an 'execution-only basis' or under a discretionary investment mandate or an advisory contract. Under such rules of the FinSA, the financial services provider must classify clients into the categories of 'professional clients', 'institutional clients' and 'retail clients', provided that retail clients can, under certain conditions, opt out from their status and become 'elective professional clients'. This change of status requires that the retail clients either have investment assets of a minimum of 500,000 Swiss francs and a minimum level of sophistication in financial matters, or a minimum of 2 million Swiss francs of investment assets.

The FinSA point of sale obligations include, among others:

1 obligation to provide disclosures to the client about services, products and costs;
2 obligation to conduct a suitability or appropriateness test (except for trades entered into on an execution-only basis);
3 documentation obligations;
4 accountability obligations;
5 transparency obligations; and
6 best execution obligation.

Note that, in respect of trades with professional clients, the financial services provider can agree with the client an upfront waiver of the obligations of (1), (3) and (4).

Also, the financial services provider can only accept inducements by third parties if they either inform the client about inducements including information on the existence, type and the value of such inducements or – if not known at this moment – about the calculation parameters of such compensations, or forward any inducement received entirely to the client.

Securities registration issues

6 Do securities registration issues arise if the issuer of the underlying shares or an affiliate of the issuer sells the issuer's shares via an OTC equity derivative?

OTC equity derivatives do not qualify as a security under Swiss law (as defined in article 2 lit. b FMIA) on the basis that they are not fungible and 'suitable for mass trading', which would be deemed to be the case if it is the intention that

- at least 20 end-investors or an unlimited number of investors may buy the products with identical terms; or
- if an application for admission to trading on a Swiss trading venue is made.

As a result, OTC equity derivatives that do not meet either of these criteria are not subject to the prospectus requirements under the FinSA and the issuer is not subject to a requirement to have the documentation approved or registered by a Swiss authority.

The issuer is, however, subject to the FMIA Obligations as discussed above. Assuming that there is no client relationship between the issuer and the counterparty, the FinSA obligations would, however, not apply.

Repurchasing shares

7 May issuers repurchase their shares directly or via a derivative?

Repurchasing own shares, directly or via derivative, is possible under Swiss law but is subject to corporate law requirements, insider trading and market manipulation regulations and, if publicly announced, to public takeover offer rules under the FMIA. The general legal framework includes mainly the FMIA, FMIO, FINMA-FMIO, FINMA Circular 2013/08 on Market Conduct Rules, Ordinance of the Takeover Board on Public Takeover Offers and the Circular No. 1 on Buy-back Programmes of the Swiss Takeover Board (TOB Circular No. 1). For tax reasons, a direct buy-back is normally executed through a 'second trading line'. The second trading line does not create a new share class or constitute a new listing for the shares to be bought back by the issuer. It is just an additional order book with its own Swiss security number. The same

shares can be traded under two separate security numbers for a limited time (the second trading line is limited in time).

Swiss corporate law restricts the capacity for a company to acquire and hold its own shares (treasury shares). Under the Swiss Code of Obligations, a Swiss company and its majority-owned subsidiaries can only acquire its own shares if:

- it has sufficient freely available equity corresponding to the purchase price; and
- the total nominal value of own shares does not exceed 10 per cent of the share capital of the company (20 per cent at maximum if acquired in connection with transfer restrictions).

This threshold of 10 per cent may be exceeded, provided that the acquisition is made with a view to reducing the share capital and the reduction is already approved by a shareholders' meeting.

From a regulatory perspective, a buy-back (irrespective of whether executed directly or through a derivative) must meet certain requirements to fall within the scope of the buy-back safe harbours. The total programme limit must not exceed 10 per cent of voting rights and capital, 20 per cent of the free float and 25 per cent of daily volume on the first trading line over a 30-day average prior to the start of the programme. The buy-back must also stay within a price cap. It must not exceed the last independent trading price or, if lower, the best offer price on the first trading line. A buy-back must take into account the rules regarding blackout periods.

Risk

8 What types of risks do dealers face in the event of a bankruptcy or insolvency of the counterparty? Do any special bankruptcy or insolvency rules apply if the counterparty is the issuer or an affiliate of the issuer?

To the extent that the dealers are relying on the enforceability of close-out netting according to the documentation of the OTC derivative (as agreed according to the terms of the relevant Master Agreement, such as an ISDA Master Agreement), the dealer faces the risk that the close-out netting may not be enforceable in the insolvency of the counterparty as agreed in the contract. The analysis depends on the insolvency rules that apply to the type of counterparty concerned. However, close-out netting provisions as stated in the market-standard master agreements for OTC derivatives (eg, an ISDA Master Agreement) are enforceable against a Swiss counterparty, as long as the contract specifies that an automatic early termination that occurs prior to the start of bankruptcy proceedings or, to the extent applicable, prior to entering into a composition agreement with assignment of assets.

Moreover, to the extent that the dealer relies on the enforcement of any collateral that was provided on the basis of a security interest, it is key to the dealer that the security interest is enforceable also in the insolvency of the counterparty.

Security interests that have been validly entered into remain enforceable in the insolvency of the counterparty. However, a right of private sale could no longer be exercised when insolvency proceedings started, except where a safe harbour rule applies. Such safe harbours are available (i) for intermediated securities pursuant to the FISA, (ii) where the collateral is provided as margin under the bilateral margin rules pursuant to the FMIA and (iii) in the insolvency of a bank or securities firm. The statutory rules may be relied on if the collateral has a market value that may be determined on the basis of objective criteria (eg, on the basis of being traded on a trading venue).

As regards reorganisation proceedings applicable to a bank or securities firm, FINMA has the power to order a temporary stay of

- any contractual termination or the exercise of such right of termination or the exercise of any rights of set-off by a counterparty;
- the enforcement of collateral; or
- the 'porting' of derivatives transactions;

in any case for up to two business days, if such contractual termination or other right would otherwise be triggered by protective measures or reorganisation proceedings.

To the extent that the reorganisation is successful and the bank meets the legal requirements after the end of the stay period, the termination right lapses. Otherwise, it may be exercised after the end of the stay period. Also, any termination that may be exercised for any reason other than FINMA ordering the protective measures or reorganisation proceedings may continue to be exercised (eg, any event of default resulting from a failure to pay or deliver).

A Swiss bank must, when entering into new agreements or amending existing agreements, agree with the counterparty the application of such resolution stay powers of FINMA, provided that the agreement is subject to a law other than Swiss law or provides for the jurisdiction of courts other than Swiss courts. FINMA defined the types of contracts falling into the scope of such obligation, subject to certain exemptions.

Reporting obligations

9 What types of reporting obligations does an issuer or a shareholder face when entering into an OTC equity derivatives transaction on the issuer's shares?

The issuer or shareholder must comply with the shareholder disclosure rules pursuant to article 120 FMIA, as any other counterparty to an OTC derivative on shares listed on SIX Swiss Exchange or BX Swiss.

In addition, the issuer or shareholder must report the transaction in compliance with the reporting obligations resulting from the FMIA to a trade repository licensed or recognised in Switzerland pursuant to the rules of article 104 et seq. FMIA, to the extent the trade is not reported by the counterparty (eg, where the counterparty is not incorporated in Switzerland).

In the event that the issuer or shareholder is a Swiss securities dealer, further reporting obligations would arise as a result of its status.

Restricted periods

10 Are counterparties restricted from entering into OTC equity derivatives transactions during certain periods? What other rules apply to OTC equity derivatives transactions that address insider trading?

OTC equity derivatives with an underlying admitted to trading on a Swiss trading venue in Switzerland are subject to the Swiss rules on insider trading and market manipulation.

Swiss law prohibits:

1. the use of insider information for the purpose of acquiring or disposing of securities or trading financial instruments with such securities as underlying (eg, derivatives);
2. disclosure of insider information to others; and
3. providing recommendations to others to enter into any transactions pursuant to (1) above.

A breach can result in both regulatory and criminal sanctions.

The FMIO contains a safe harbour regime for repurchases of own shares under a share buy-back programme, subject to compliance with the following blackout periods during which the safe harbour regime does not apply:

- as long as the issuer postpones the announcement of a price-sensitive fact pursuant to the stock exchange rules;
- 10 trading days prior to the public announcement of financial results; and

- the period starting nine months after publication of the latest consolidated financial statements.

Under certain conditions, a securities firm may continue trading during the blackout period, provided that the terms of the trades were fixed in advance and they are not changed more frequently than on a monthly basis or, during a blackout period, taking into account a 90-day waiting period.

Legal issues

11 What additional legal issues arise if a counterparty to an OTC equity derivatives transaction is the issuer of the underlying shares or an affiliate of the issuer?

The issuer must comply with the requirements of Swiss corporate law, including, for example, the limitations regarding the acquisition of own shares (which applies also to the acquisition of shares in the issuer by a majority-owned subsidiary).

Tax issues

12 What types of taxation issues arise in issuer OTC equity derivatives transactions and third-party OTC equity derivatives transactions?

OTC equity derivatives do not qualify as taxable securities within the meaning of the Swiss Stamp Duty Act, which is why transactions with OTC equity derivatives are not subject to Swiss securities transfer tax. Income from OTC equity derivatives is not subject to Swiss withholding tax either. However, the reimbursement of the Swiss withholding tax should be approached with caution. This is particularly the case if the formal owner of shares in a Swiss company and thus the recipient of dividend payments subject to Swiss withholding tax has entered into an OTC equity derivatives transaction with a counterparty receiving the economic benefit resulting from the shares. In those cases, the Federal Tax Administration regularly assumes, relying on Federal Supreme Court case law, that the formal owner of the shares is obliged to pass on at least part of the dividend payment due to the derivative transaction. This in turn has the consequence that the Federal Tax Administration does not qualify the formal owner of the shares as the beneficial owner of the dividend payment. The beneficial ownership is, however, one of the cumulative requirements to be fulfilled for a withholding tax refund, in both domestic and cross-border trade relationships. Ultimately, because the beneficial ownership is not recognised from a tax perspective due to the OTC equity derivatives transaction, the withholding tax refund on the dividend payments to the formal owner of the shares is also denied.

Liability regime

13 Describe the liability regime related to OTC equity derivatives transactions. What transaction participants are subject to liability?

The general principles on contract liability and specific contractual provisions apply to the contractual liability regime related to OTC equity derivatives transactions.

Stock exchange filings

14 What stock exchange filings must be made in connection with OTC equity derivatives transactions?

Under the FMIA and pursuant to the FINMA Circular 2018/02 on the Duty to Report Securities Transactions, Swiss securities firms and remote members of a Swiss trading venue must report transactions in securities admitted to trading on a Swiss trading venue and in OTC derivatives with such securities as underlying, provided that at least one underlying value weighs more than 25 per cent.

If the underlying shares are listed on SIX Swiss Exchange or BX Swiss, any parties to the OTC derivative must comply with the shareholder disclosure rules pursuant to article 120 FMIA. To the extent that they cross a relevant threshold (either by exceeding or falling below 3, 5, 10, 15, 20, 25, 33⅓, 50 and 66⅔ per cent of the voting rights represented by the shares in such listed company as the relevant thresholds), they must make a disclosure to the issuer and the exchange by the end of the fourth trading day after crossing the threshold. The information is published by the exchange. A disclosure must be made as soon as an investor reaches or exceeds one of the thresholds with either its long position in the shares (physical shareholding aggregated with any rights to receive delivery of shares and any other long positions in respect of the shares, for example, arising from a derivatives transaction) or its short positions entered into in respect of the shares (eg, obligations to deliver shares or any short positions arising from a derivatives transaction). For the purposes of this calculation, the long and short positions must not be netted. The long and short positions arising from derivatives transactions are counted irrespective of whether they are cash or physically settled.

Typical document types

15 What types of documents are typical in an OTC equity derivatives transaction?

In the interdealer market, the documentation normally includes a Master Agreement for OTC derivatives transactions (usually a 2002 or 1992 ISDA Master Agreement), entered into jointly with the relevant credit support documentation that is suitable for the master agreement and the trading relationship (eg, a 1995 Credit Support Annex governed by English law entered into in respect of an English law governed ISDA Master Agreement, as amended for the purposes of compliance with variation margin requirements under the regulatory regimes applicable to both counterparties or a 2016 VM ISDA Credit Support Annex) and, in respect of the transaction, a transaction confirmation.

Moreover, depending on whether the dealers are subject to initial margin requirements, the dealers may have to take into account the transaction for the purposes of calculating initial margin in accordance with the relevant initial margin documentation entered into between the two dealers.

As regards the relationship between a dealer and a client, the documentation varies depending on the client relationship and the type of transaction. It may include a Master Agreement for OTC derivatives transactions (such as an ISDA master agreement or a Swiss Master Agreement published by the Swiss Bankers Association) and, in respect of the transaction, a transaction confirmation. The security may be provided under a credit support document entered into in connection with the master agreement, to the extent that the client falls into the scope of bilateral margin requirement (ie, if the client is an FC or an NFC+) or if such credit support document is in place on a voluntary basis. Where the client is not falling into the scope of bilateral margin requirements, security may be provided under a pledge agreement used by the bank in the client relationship generally that only provides security unilaterally by the client to the dealer.

If the transaction is a one-off transaction, it may be documented under a 'long form confirmation' incorporating the terms of an ISDA Master Agreement.

Legal opinions

16 For what types of OTC equity derivatives transactions are legal opinions typically given?

To the extent that a dealer is relying on close-out netting for its regulatory capital calculations and the credit risk analysis, it is relying on a netting and collateral enforceability opinion. Under documentation governed by ISDA terms, these are usually the industry opinions available to ISDA members, as supplemented by supplemental opinions in the event that the relevant counterparties or transactions are not covered by the industry opinions.

Hedging activities

17 May an issuer lend its shares or enter into a repurchase transaction with respect to its shares to support hedging activities by third parties in the issuer's shares?

Yes.

Securities registration

18 What securities registration or other issues arise if a borrower pledges restricted or controlling shareholdings to secure a margin loan or a collar loan?

The pledge by a borrower of its shares to secure a loan does not trigger securities registration or the duty to issue a prospectus. The validity of the pledge over shares is in particular subject to the requirements of Swiss law depending on the type of shares (eg, intermediated securities, uncertificated securities or certificated securities).

Borrower bankruptcy

19 If a borrower in a margin loan files for bankruptcy protection, can the lender seize and sell the pledged shares without interference from the bankruptcy court or any other creditors of the borrower? If not, what techniques are used to reduce the lender's risk that the borrower will file for bankruptcy or to prevent the bankruptcy court from staying enforcement of the lender's remedies?

Security interests that have been validly entered into remain enforceable in the insolvency of the counterparty. As regards the exercise of rights of private sale, the statutory rules applicable to intermediated securities, to banks or securities firms and to parties falling into the scope of the bilateral margin requirements under the FMIA provide for a safe harbour that may be relied on if the collateral has a market value that may be determined on the basis of objective criteria (eg, on the basis of being traded on a trading venue).

Market structure

20 What is the structure of the market for listed equity options?

Switzerland does not currently have trading venues incorporated in Switzerland, where ETDs are traded. ETDs are traded with trading venues outside Switzerland and cleared through non-Swiss central counterparties (CCPs). To the extent that such trading venues or CCPs admit direct participants incorporated or domiciled in Switzerland, the trading venues and CCPs require recognition by FINMA.

Governing rules

21 Describe the rules governing the trading of listed equity options.

These rules are those of the relevant foreign market of the trading venue and CCP.

From a Swiss regulatory perspective, such transactions fall into the scope of the reporting obligation under the FMIA. In the clearing chain, the Swiss party closer to the CCP has such reporting obligation.

TYPES OF TRANSACTION

Clearing transactions

22 What categories of equity derivatives transactions must be centrally cleared and what rules govern clearing?

Under the rules of the FMIA, equity derivatives do not fall into the scope of the clearing obligation.

Exchange-trading

23 What categories of equity derivatives must be exchange-traded and what rules govern trading?

Under the rules of the FMIA, equity derivatives do not fall into the scope of a venue trading obligation.

Collateral arrangements

24 Describe common collateral arrangements for listed, cleared and uncleared equity derivatives transactions.

As regards ETDs and cleared equity derivatives:

- at present, there are no Swiss CCPs clearing equity derivatives. The clearing chain therefore is entered into, on the level of the CCP, with a foreign entity subject to its rules; and
- the collateral terms between the client and a Swiss dealer are usually agreed in the general terms governing ETDs and cleared equity derivatives.

As regards uncleared OTC equity derivatives:

- the collateral arrangements are agreed with the counterparty concerned on a bilateral basis;
- to the extent that the parties are subject to regulatory margin requirements, the parties may use the market standard document for the exchange of variation margin (eg, a 2016 VM ISDA Credit Support Annex) and, as applicable, the relevant documentation for the exchange of initial margin; and
- to the extent that the parties are not subject to regulatory margin requirements, the collateral documentation often depends on the context of the trading relationship. For instance, if it arises from the wealth management business, Swiss dealers may prefer to enter into a pledge agreement for a one-way collateralisation providing security to them as opposed to entering into a credit support document that would provide for bilateral margining.

Exchanging collateral

25 Must counterparties exchange collateral for some categories of equity derivatives transactions?

To the extent that the parties to the transaction fall into the scope of the bilateral margining obligation under the FMIA (ie, if they are FCs or NFC+), they must exchange collateral in the trading relationship (obligation to exchange variation margin, and, if they cross the relevant thresholds, initial margin).

ETDs and cleared equity derivatives that are cleared with a CCP authorised by FINMA do not fall into the scope of such obligations.

As regards the product scope for uncleared equity derivatives, an exemption applies for options on single shares, on share baskets or equity index options. For such exempted products, the obligation to exchange variation and initial margin has been postponed until 1 January 2024. For all other uncleared equity derivatives, the bilateral margin obligations apply in full.

LIABILITY AND ENFORCEMENT

Territorial scope of regulations

26 What is the territorial scope of the laws and regulations governing listed, cleared and uncleared equity derivatives transactions?

The FMIA Obligations apply to parties incorporated or domiciled in Switzerland. They do not apply to parties incorporated or domiciled outside Switzerland, even if they act through a Swiss branch.

However, a foreign counterparty would be indirectly impacted by the FMIA Obligations as a result of trading with a Swiss counterparty that must comply with the FMIA Obligations, to the extent that the compliance by the Swiss party requires entering into certain agreements with the foreign counterparty (eg, an FMIA Agreement or the relevant credit support documentation to comply with the bilateral margin obligations resulting from the FMIA).

Registration and authorisation requirements

27 What registration or authorisation requirements apply to market participants that deal or invest in equity derivatives, and what are the implications of registration?

To the extent that the equity derivatives are not securities, there are no registration or authorisation requirements for market participants.

If equity derivatives are securities (eg, ETDs), a licence as a securities firm may be required from the FINMA, subject to the conditions under the Swiss Financial Institutions Act, for:

- trading in securities in its own name for the account of clients;
- own account trading in securities, provided that the firm:
  - operates primarily on the financial market; and
  - could thereby jeopardise the proper functioning of the financial market (ie, generates an annual turnover in securities exceeding 5 billion Swiss francs) or is a direct member of a trading venue or operates an organised trading facility; or
- acting as a market maker in securities.

Reporting requirements

28 What reporting requirements apply to market participants that deal or invest in equity derivatives?

If the underlying shares are listed on SIX Swiss Exchange or BX Swiss, parties to the OTC derivative must comply with the shareholder disclosure rules pursuant to article 120 FMIA. To the extent that they cross a relevant threshold (either by exceeding or falling below 3, 5, 10, 15, 20, 25, 33⅓, 50 and 66⅔ per cent of the voting rights represented by the shares in such listed company as the relevant thresholds), they must make a disclosure to the issuer and the exchange by the end of the fourth trading day after crossing the threshold. The information is published by the exchange.

In addition, the relevant party must report the transaction in compliance with the reporting obligations resulting from the FMIA to a trade repository licensed or recognised in Switzerland pursuant to the rules of article 104 et seq. FMIA, to the extent the trade is not reported by the counterparty (eg, where the counterparty is not incorporated in Switzerland).

In the event that the issuer is a Swiss securities dealer, further reporting obligations would arise as a result of its status.

Legal issues

29 What legal issues arise in the design and issuance of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares? What additional disclosure and other legal issues arise if the structured product is linked to a proprietary index?

Structured products are, unlike collective investment schemes, not subject to authorisation or supervision by FINMA. To distinguish both products, FINMA takes a 'form over substance' approach and looks primarily at the labelling of the product. The decision to qualify the product as a structured product must be made by the issuer prior to product launch and must be communicated to investors.

The offering, in or from Switzerland, of structured products to retail clients outside a portfolio management mandate or an investment advisory mandate in the long term is only possible if:

- they are issued or guaranteed by either a Swiss bank, a Swiss insurance company, a Swiss securities firm or a foreign institution subject to equivalent prudential supervision; or
- where the issuer does not meet these requirements (eg, it is a special-purpose entity) and they are not so guaranteed, a regulated entity undertakes to put the issuer in a position to meet its obligations or the investors are collateralised with enforceable rights in collateral assets.

If structured products are offered publicly or admitted to trading on a Swiss trading venue, the issuer must prepare a prospectus. A prospectus may be prepared in the form of a programme with final terms documenting an issuance, which is the standard for the issuance of structured products. Only the programme is approved by the Swiss Prospectus Office, while the final terms are just registered.

If structured products are offered to retail clients, the issuer must also prepare a Key Information Document (KID) in compliance with the requirements of the FinSA or the EU PRIIPs Regulation.

In the event that the underlying of the structured products are managed (actively managed certificate, AMC), they would not be classified as collective investment schemes from a Swiss perspective, as long as they are clearly labelled as structured products. However, further regulatory questions arise such as the adequate licensing of the manager or sponsor. In the event that the underlying of the structured products is a collective investment scheme, the question arises whether this would be viewed as an indirect distribution of such underlying in Switzerland. This would be deemed to be so where the weight of any collective investment scheme is more than a third.

Liability regime

30 Describe the liability regime related to the issuance of structured products.

Whoever discloses information in a prospectus or a KID that is inaccurate, misleading or in violation of statutory requirements, is liable to the investor for damages caused if he or she failed to exercise due care. This also applies in the event the issuer fails to publish a prospectus despite being obliged to do so.

Moreover, an issuer could be subject to criminal sanctions. A fine of up to 500,000 Swiss francs may be imposed on anyone who intentionally makes false statements in the prospectus or withholds material facts or fails to publish a prospectus when the public offer begins. A fine of up to

100,000 Swiss francs may be imposed on anyone who intentionally does not make available (if needed) the KID to a retail client before subscription. A fine of up to 500,000 Swiss francs may be imposed on anyone who intentionally offers structured products to retail clients without complying with article 70 FinSA, including the requirement to be issued, guaranteed or secured. Banks and other financial intermediaries supervised by FINMA, as well as persons working for them, are, however, exempt from this criminal sanction regime.

Other issues

31 What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is convertible for shares of the same issuer?

According to the FinSA, anyone who submits a public offer to purchase securities in Switzerland or applies for admission of securities to trading on a Swiss trading venue in accordance with the FMIA is obliged to publish a prospectus in advance.

Securities include, among others, equity securities and convertible bonds and the duty to publish a prospectus applies not only to primary offerings but also to secondary offerings (there are some exceptions for secondary offerings by supervised financial services providers if a valid prospectus is available and the issuer has consented to its use). There are some exceptions from the prospectus requirement.

For example, there is no obligation to publish a prospectus if a public offer is directed only at professional investors or at fewer than 500 retail investors. An exemption also applies for securities with a minimum investment amount or denominations of at least 100,000 Swiss francs and issues of a total of no more than 8,000,000 Swiss francs p.a.

The FinSA provides for exemptions in connection with admission to trading, for example in case of equity securities that, over a period of 12 months, account for less than 20 per cent of equity securities already admitted to trading on the same trading venue.

Before being published, the prospectus must be submitted to a Swiss Prospectus Office (ie, SIX Exchange Regulation AG or BX Swiss AG as of today) for their approval. As a significant exception to the requirement of ex-ante approval (but not prior publication) of the prospectus, Appendix 7 of the FinSO provides that for the purpose of rapid market access for bonds (including convertible and exchangeable bonds, warrant bonds, mandatory convertible notes, contingent convertible bonds and write-down bonds) and structured products with a maturity of at least 30 days, the prospectus may be reviewed after its publication (ie, ex-post). The exception requires a bank or securities firm to confirm that the most important information about the issuer and the securities is available at the time of publication.

If no prospectus is required, offerors or issuers must treat investors equally if they provide them with material information about a public offering.

32 What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is exchangeable for shares of a third party? Does it matter whether the third party is an affiliate of the issuer?

No material other issues are to be reported as regards the issuance of exchangeable bonds.

Schellenberg Wittmer

Olivier Favre
Olivier.favre@swlegal.ch

Tarek Houdrouge
Tarek.houdrouge@swlegal.ch

Löwenstrasse 19
PO Box 2201
8021 Zurich
Switzerland
Tel +41 44 215 5252
Fax +41 44 215 5200

15bis, rue des Alpes
PO Box 2088
1211 Geneva 1
Switzerland
Tel +41 22 707 8000
Fax +41 22 707 8001

6 Battery Road, #37-02
Singapore 049909
Singapore
Tel +65 6580 2240
Fax +65 6580 2241

www.swlegal.ch

UPDATE AND TRENDS

Recent developments

33 Are there any current developments or emerging trends that should be noted?

To the extent that equity derivatives transactions include cashflows based on LIBOR rates (eg, an equity swap or an equity financing transaction) and has a term beyond the end or non-representativeness of LIBOR (on the basis of the announcement by the FCA on 5 March 2021, beyond 31 December 2021 for GBP, JPY, CHF, EUR and the one-week and two-months USD-LIBOR settings and, as regards the other USD-LIBOR settings, beyond 31 June 2023), the parties must include the relevant fallback provisions. This may occur on the basis of the adherence to the 2020 LIBOR Fallbacks Protocol published by ISDA or the incorporation of the terms of such protocol by way of a bilateral agreement (eg, in the Swiss market by way of entering into the Benchmark Amendment Agreement in the form as published by the Swiss Bankers Association). For new transactions that are entered into by reference to LIBOR rates, this may occur by incorporating the ISDA 2006 Definitions (including Supplement 70 thereto) or, when they will be available for use, the ISDA 2021 Definitions.

The initial margin documentation that may be used in the Swiss market also includes now industry-standard documentation that may be agreed with SIX SIS Ltd as Swiss custodian for intermediated securities to be exchanged as initial margin.

Coronavirus

34 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

Switzerland passed special legislation by way of ordinances, for example certain exemptions under the insolvency regime and to facilitate the holding of shareholders' meetings in times of coronavirus, that are no longer in force. There are no specific points to mention for equity derivatives.

In practice, it is always advisable to review contracts to determine if they can be affected or not by the pandemic (eg, in view of the question whether a party can suspend or excuse performance of its contractual obligations).

Other titles available in this series

Acquisition Finance
Advertising & Marketing
Agribusiness
Air Transport
Anti-Corruption Regulation
Anti-Money Laundering
Appeals
Arbitration
Art Law
Asset Recovery
Automotive
Aviation Finance & Leasing
Aviation Liability
Banking Regulation
Business & Human Rights
Cartel Regulation
Class Actions
Cloud Computing
Commercial Contracts
Competition Compliance
Complex Commercial Litigation
Construction
Copyright
Corporate Governance
Corporate Immigration
Corporate Reorganisations
Cybersecurity
Data Protection & Privacy
Debt Capital Markets
Defence & Security Procurement
Dispute Resolution
Distribution & Agency
Domains & Domain Names
Dominance
Drone Regulation
e-Commerce
Electricity Regulation
Energy Disputes
Enforcement of Foreign Judgments
Environment & Climate Regulation
Equity Derivatives
Executive Compensation & Employee Benefits
Financial Services Compliance
Financial Services Litigation
Fintech
Foreign Investment Review
Franchise
Fund Management
Gaming
Gas Regulation
Government Investigations
Government Relations
Healthcare Enforcement & Litigation
Healthcare M&A
High-Yield Debt
Initial Public Offerings
Insurance & Reinsurance
Insurance Litigation
Intellectual Property & Antitrust
Investment Treaty Arbitration
Islamic Finance & Markets
Joint Ventures
Labour & Employment
Legal Privilege & Professional Secrecy
Licensing
Life Sciences
Litigation Funding
Loans & Secured Financing
Luxury & Fashion
M&A Litigation
Mediation
Merger Control
Mining
Oil Regulation
Partnerships
Patents
Pensions & Retirement Plans
Pharma & Medical Device Regulation
Pharmaceutical Antitrust
Ports & Terminals
Private Antitrust Litigation
Private Banking & Wealth Management
Private Client
Private Equity
Private M&A
Product Liability
Product Recall
Project Finance
Public M&A
Public Procurement
Public-Private Partnerships
Rail Transport
Real Estate
Real Estate M&A
Renewable Energy
Restructuring & Insolvency
Right of Publicity
Risk & Compliance Management
Securities Finance
Securities Litigation
Shareholder Activism & Engagement
Ship Finance
Shipbuilding
Shipping
Sovereign Immunity
Sports Law
State Aid
Structured Finance & Securitisation
Tax Controversy
Tax on Inbound Investment
Technology M&A
Telecoms & Media
Trade & Customs
Trademarks
Transfer Pricing
Vertical Agreements

Also available digitally

lexology.com/gtdt

an LBR business

ISBN 978-1-83862-657-0