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Long procedures and stricter rules: high expectations vs. reality in the revised disclosure and takeover legislation

Ladies and Gentlemen

Permit me if I may to begin my speech with a little plagiarism. I would like to quote some headlines of recent months. Should any of their authors be present here today, I hope they will forgive me for borrowing their work. "Criticism of supervisory body", "SFBC proceedings take too long", "The wheels of the SFBC grind too slowly", "Tame SFBC", "SFBC reluctant to show its teeth." Admittedly there have also been some positive comments, such as "SFBC tightens the screw" or "SFBC shows its muscle." Public opinion, however, is more likely to have been influenced by the critical voices.

Such criticism of the supervisory body is understandable. Last year, we found ourselves in an enormously turbulent economic environment – a situation that still persists today. After my speech, Mr Zuberbühler will examine the big issue of recent months: the financial market crisis. In addition, cases such as Sulzer, OC Oerlikon, Laxey/Implenia and, lately, Focus Capital have hit the headlines. What all these issues have in common is that the public at large expect to be kept fully informed. Another common factor is that they have led to profound unease. In all of them, too, the SFBC plays an important role. Only too often, however, are we unable to satisfy the public's need for explanation, certain knowledge and clear information. That is no doubt an important reason for criticism.

It is entirely clear to me that from the perspective of the media, the general public and the parties involved, our proceedings take a long time. Statements by our media spokespeople that "we are unable to comment on proceedings that are ongoing" hardly serve to shorten the wait. In the first part of my comments I should like to briefly explain, with reference to financial market enforcement in the area of disclosure and takeover law, why we are often unable to fully meet public expectations regarding information and length of proceedings. I will then turn to our initial experience with the new, more stringent disclosure law, and the potential for improvements. Finally, I shall venture a brief look ahead to the upcoming FINMA.

The time factor from the perspective of the legal system

The SFBC's statutory mandate essentially comprises the supervision of banks, the securities markets and collective investment schemes. It monitors and ensures that authorisation requirements are met at all times, and that all players in the financial market adhere to the law. It is regrettable but true that, whether intentionally or otherwise, the laws and regulations are sometimes circumvented. This is where financial market enforcement comes in. By financial market enforcement, we mean all the statutory tasks of the SFBC that are directed towards identifying, correcting and (if necessary) imposing sanctions on infringements of the law and irregularities.

In the process, the SFBC must steer a careful course between two potential hazards:

- On the one hand, it must conduct its proceedings rapidly, resolutely and in a focused manner. Only in this way can it avoid allegations of inactivity or incapacity.
- On the other hand, however, it must play by the rules – the procedural law – and conduct all proceedings in a fair and irreproachable way. Only in this way will it avoid coming to grief in the courts.

From the point of view of those affected, the second point is absolutely crucial. They have a right to a fair hearing. Indeed, in a state governed by the rule of law, no other course of conduct is worthy of the authority concerned. Yet this also has far-reaching consequences: the facts need to be thoroughly investigated, documents need to be inspected, and those affected need to be given an opportunity to express their views and raise their objections. All of this takes time.

Generally, the SFBC manages to conduct proceedings rapidly. It reaches its decisions with particular speed in cases where the issue concerns its supervisory purview. If a company appears on the radar screen that is suspected of acting illegally, decisions often take less than two months to be reached. Proceedings against authorised institutions are normally more complex. They can take around six to eight months, and in difficult cases – unfortunately – sometimes longer.

Proceedings in which more than one person needs to be examined, and individual responsibilities need to be clarified, are particularly time-consuming. If a number of parties are involved and each seeks to pin blame on the others, the matter becomes still more complex. On occasion, the parties concerned actually have a vested interest in dragging the proceedings out.

It is precisely in complex cases such as these that the time factor plays a major role. The SFBC is not in a position to ordain how long the proceedings are to take and impose its will in this way. We are bound by a plethora of procedural regulations laid down by the state. Yet even if proceedings often fail to advance as quickly as we like, the SFBC's performance holds up well in comparison with its international counterparts. By such a benchmark, the duration of our proceedings is entirely respectable.

The time factor from the perspective of the general public

From the point of view of the media, the public and some of those involved, things naturally look different. The media inevitably operate on a different timeframe to an authority such as the SFBC, and are understandably interested in the immediate resolution of issues they view as being of burning importance. For them, the six to twelve months or more that it may take to bring more complex proceedings to a close seems like an eternity. By then, the story may well be old news. Those directly involved, meanwhile, are under intense public pressure during the proceedings, and may even be restricted in their power to act. We are fully aware of these implications. Nevertheless, where the case is complex, the SFBC must take the time it needs to conduct proceedings responsibly and in accordance with the rule of law.

As I mentioned at the start, when the situation is tense, the mood becomes more aggressive. Indiscretions feed the rumour mill and demands have been made that are tantamount to insisting that supervisory activity should be carried out in the full glare of publicity. The SFBC has run the risk of being judged not in terms of its clear statutory mandate, but rather on the basis of rapid and spectacular decisions. This bears no relation to the reality of procedural law, nor does it guarantee the requisite protection for creditors. On the contrary, an authority bound by the rule of law that allowed itself to be put under time pressure in this way would be failing in its duty to the parties involved, and would sacrifice its reputation in the process. It also needs to be stated loud and clear that supervision is not a public activity and cannot be subject to public debate. Excessive publicity can jeopardise the course of proceedings and even render them impossible, and seriously damage the legal position of the parties. This must be avoided at all costs.

I should now like to address the issue more specifically, by offering an account of initial experience with the revised disclosure law against the backdrop of proceedings such as those I have mentioned.

An unambiguously forward-looking market supervision strategy

Our Stock Exchange Act, which has just celebrated its tenth birthday, requires shareholders to disclose their holdings in listed Swiss companies once certain thresholds are reached. The aim is to make the covert acquisition or disposal of holdings impossible, and thereby to achieve two key goals of the Act: transparency for market participants and protection for minority shareholders.

But are these goals actually being achieved; or, to put it another way, can the SFBC as market supervisory authority adequately fulfil its mandate?

Let us recall that the years since 2006 have seen a rising number of takeover battles in Switzerland in which investors – most of them foreign – have sought to exploit loopholes in the system for disclosing holdings in order to accumulate a substantial stake in listed Swiss companies without being noticed. The SFBC has responded by launching investigations, some of them very wide-ranging. These investigations clearly showed, and continue to show, that the substantive law, the investigatory powers of the Banking

Commission, and the tools available to enforce the duty of disclosure (reporting obligations) and to sanction breaches are wholly inadequate.

Parliament took up these cases, and tightened up the Stock Exchange Act with effect from 1 December 2007. The main emphasis was on the following points:

- The introduction of new 3%, 15% and 25% thresholds enhances transparency by improving the early warning system during public takeovers and increasing the protection offered to small and minority shareholders.

- Action has been taken to counteract the covert accumulation of holdings with a view to a public takeover offer, by extending the reporting obligation to all financial instruments that can be used as an expedient to achieve this.

- Finally, the civil court judge responsible may, on application from the supervisory authority, the company or one of its shareholders, suspend voting rights for failure to comply with the reporting obligations.

As far back as 1 July 2007, the SFBC tightened up the disclosure rules as they affect its powers by revising its Stock Exchange Ordinance, introducing a reporting obligation for derivatives regardless of whether actual performance is either envisaged or permitted. The SFBC also abolished the 5% exemption threshold for derivatives, which the rapid development of the derivatives market in recent years had rendered unjustifiable. The removal of this exemption, especially in conjunction with the lowering of the first reporting threshold to 3%, constituted a major tightening up of reporting obligations.

There is no doubt that these extensions to the reporting obligations can improve market transparency in the area of disclosure and takeovers. Yet it is equally clear that they lead to extra work and costs for the shareholders to whom they apply, for the banks and for the supervisory bodies. Crucially, indeed, the new flood of information – the lowering of the first reporting threshold to 3% has resulted in around twice as many reports – threatens in its turn the very transparency it sets out to achieve. Being the supervisory authority, we are aware of this problem: in our capacity as promulgator of ordinances, we have therefore sought, wherever possible, to implement the clear requirements of the legislature with an eye to practical considerations. We also support the approach of the SWX disclosure office, which has been pragmatically developing the new reporting practice since December 2007 with some 60 formal recommendations.

Initial experience from ongoing investigations and proceedings

What has been our experience of investigations and proceedings concerning breaches of the disclosure rules, some of which are still ongoing? I wish to demonstrate that the SFBC is willing to make full use of the limited arsenal of procedural measures currently at its disposal, and indeed has actually done so. The procedural difficulties I mentioned at the outset are increased exponentially during investigations into investors – mostly foreign – who are not subject to the prudential supervision of the SFBC and on whom it is therefore impossible to impose supervisory sanctions. Indeed, the international dimension of those investigations, involving lengthy requests for administrative assistance and often highly complex circumstances, renders (multi-party) proceedings extremely time-consuming. But it does not prevent them from being concluded.

In the specific case of Laxey / Implenia, the SFBC has demonstrated that the assessment of the reporting obligation extends beyond the somewhat technical issue of simple ownership of financial instruments to encompass the positions covered by the reporting obligation themselves. Having completed a comprehensive investigative and administrative process, the SFBC issued a declaratory ruling stating that Laxey had de facto placed Implenia shares with counterparties (parking), while reserving the right to redeem the shares at any time through contracts for difference. As Laxey thus retained potential control over the voting rights associated with these shares, the shares were effectively owned by Laxey following the conclusion of the CFD transactions. Since this is a clear circumvention of the rules, a strategy of this type constitutes indirect acquisition of shares within the meaning of the stock exchange legislation, and is therefore likewise subject to the duty of disclosure. As a clause intended to prevent abuse, the relevant provision of the stock exchange legislation includes all forms of transaction that enable the transmission or acquisition of voting rights.

The SFBC has decided in principle that, when infringements of the reporting obligation are identified, it should in future make full use not only of the “traditional” complaint to the Federal Department of Finance but also of the option for administrative declaratory rulings, especially against unregulated investors. This approach will enable the SFBC to retain procedural authority over the investigations and the action resulting from them. The issuing of a ruling enables the contravention of the disclosure requirements to be formally stated and communicated to the parties, including market participants who are either interested or directly affected, thereby upholding the necessary market transparency and integrity. The SFBC also intends, on a case-by-case basis, to make use of the newly created option to instigate civil proceedings for suspension of voting rights.

So far so good. The fact remains, though, that the regulatory armoury now available is inadequate to ensure efficient and credible enforcement. The strategy of forward movement on which the SFBC has embarked requires additional tools, especially where disclosure and takeover law is concerned. Infringements of the reporting obligation will, from next year onwards, be a criminal offence not only if intentional but also if they are the result of negligence, and this will lead to more criminal proceedings and simplify the gathering of evidence. There remains, however, a latent problem of enforcement, as resources are in short supply at the SFBC and the Department of Finance, and Switzerland does not have a general regime of market supervision with appropriate powers of investigation and sanction.

Need for more effective disclosure rules and instruments

Our experience, especially in connection with serious breaches of the reporting obligation, shows that there is a need for even more effective disclosure rules and instruments. The implementation of disclosure legislation is a matter of supervisory law, and powerful supervisory tools are therefore required in order to achieve it. As the current situation shows, the remedies available under both criminal and – as with the new suspension of voting rights by a civil court judge – civil law are too cumbersome. A scenario in which the implementation of measures to enforce reporting obligations is decreed by the supervisory authority – which is the expert in such matters – promises much greater efficiency, in terms of both speed and practical results.

The SFBC therefore believes that the following points deserve serious examination:

- the extension of the use of commissioned investigators to include investors outside the regulated financial sectors
- the suspension of voting rights not by a civil court judge but as a supervisory law measure which the supervisory authority is empowered to take
- the seizure of illegally obtained profits
- a prohibition on buying securities of the issuer concerned or of companies traded or listed in Switzerland, and even
- compulsory sale up to the level of the most recent properly declared threshold.

I have focused primarily on disclosure law. However, the strategy of forward movement must not remain limited to this area. I should therefore like to mention, at least briefly, a selection of issues for which the SFBC is responsible or where it is at least involved, and which I believe are very important:

- The SFBC recently adopted its new circular “Supervisory Rules on Market Conduct in Securities Dealing” (Market Conduct Rules), which comes into force on 1 May 2008. The circular lays down – in the form of principles rather than detailed regulations – supervisory rules on market conduct for the financial intermediaries under the SFBC’s supervision, and provides instructions on avoiding market abuse.
- The Banking Commission has long regretted the fact that the definition of insider dealing is limited to situations akin to issues and mergers. The partial revision of Art. 161 of the Penal Code, i.e. the repeal of point 3 will – finally, I must add – rectify this shortcoming. The extension is an important first step; though it closes only one loophole, albeit an important one.
- The upcoming complete revision of Art. 161 and Art. 161bis of the Penal Code relating to insider dealing and price manipulation should rectify the many additional shortcomings we believe still exist. It is in the interests of our financial sector that our standards should be brought more closely in line with those of our international counterparts, and that effective measures be developed to combat abuse. There is a clear need for revision where these financial market offences are concerned.
- This will give supervision of the markets by FINMA a new and important status, with the resources to match. Effective market supervision is vital to the reputation of our financial centre.

Looking ahead to FINMA

I would like to close with a brief look ahead to the new financial market supervisory authority FINMA. In just a few months – on 1 January 2009 – the SFBC will cease to exist as a component of financial market supervision in Switzerland. It will be merged with the bodies responsible for supervision of insurance companies (the Federal Office of Private Insurance) and financial intermediaries under the Anti-Money Laundering Act (the

Money Laundering Reporting Office) to form the new Federal Financial Market Supervisory Authority FINMA, which will supersede it. The press conference you are attending here today is therefore something of a historic event.

Although the SFBC will soon be part of legal history, its tasks and responsibilities will be transferred seamlessly to the new FINMA. The same naturally applies to the other authorities. FINMA will benefit from the experience of its predecessor organisations. It must maintain their tried and tested practice, but must also be fit for the demands of the future, and therefore continue to develop. The planning and implementation of the new financial market supervisory system is a challenge.

The countdown to the operational launch of FINMA has already begun. With the passing of the federal law on financial market supervision (FINMAG) in summer 2007 and its partial implementation on 1 January 2008, the preparations for the merger have entered a new and more concrete phase. The appointment of the board of directors by the Federal Council in January 2008 was a further step forwards. The board of directors is not yet engaged in any operational activity, but it is setting the new body’s strategic course and assisting in the preparations for merging the three authorities. One of its first key tasks is the internal and external recruitment of the new CEO (which must be confirmed by the Federal Council) and the executive management. This process is currently ongoing. These activities are guided by the need to build on existing know-how and complement it with new expertise. I hope that the CEO and the first management level will be announced this summer.

There has been much discussion recently about resources for FINMA. Media and politicians alike have been asking whether, given the current financial market turbulence, the banking supervisory system has the resources it needs. The answer is yes, at least for our statutory mandate as it is currently understood. That is not to deny that individual departments occasionally come up against the limits of their capacities. In such cases, the existing teams need to be supplemented by targeted measures and require the support of additional specialists. But FINMA need not necessarily grow larger. Bigger is not necessarily better – or, where supervision is concerned, safer. FINMA must increase its strength in areas where bottlenecks are occurring today.

This also answers a second important question that has been much discussed in recent weeks. Yes, the three merging authorities already have well-trained staff who are committed, focused and effective. But the future authority must be given new opportunities to acquire and retain qualified and experienced specialists. Although Parliament has decided that FINMA's staff will continue to be employed under public law, their conditions of employment are to be set out in a special set of staff regulations that will require the approval of the Federal Council. However, those regulations must offer more flexibility than the current solution, especially where remuneration is concerned. I will be arguing the case for this, and I trust that the political authorities will appreciate my position. If FINMA is to meet the growing challenges of the future, it must have greater freedom to ensure its attractiveness for qualified staff. The IMF also expects this, and indeed has again expressed its support for this view.

The preparations are on course. We have already progressed some way along the path to the new FINMA, but many hurdles still lie ahead. Not all the issues and problems will be resolved on the day it begins work, but we have a common aim: the new FINMA must be a comprehensive market supervisory system for Switzerland, one that is not only efficient but also has a powerful international presence and therefore contributes to our credibility. We are convinced that a good reputation will benefit both clients of the institutions that are to be supervised and Switzerland itself, as one of the world's most important financial centres.