Equity Derivatives 2019

Contributing editors
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Getting The Deal Through

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Lexology Getting The Deal Through is delighted to publish the fourth 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.

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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.

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Getting The Deal Through

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Switzerland

Patrick Hünerwadel, Patrick Schleiffer and Olivier Stahler

Lenz & Staehelin

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?

The typical uses of OTC equity derivatives are margin loans, used to finance or leverage large shareholdings, including shares to be purchased in an acquisition; put and call transactions or swaps (including total return swaps) used to acquire an economic interest in a company, including situations in which the company may become a target in a takeover; swaps used by an issuer to hedge its exposure under its employee benefit plans; and share loans, share sale and repurchase transactions.

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

The SIX Swiss Exchange has published trading directives that contain rules on short selling. According to such rules, short selling of securities traded on SIX Swiss Exchange is permitted if the selling party is able to settle the short selling transaction within the deadline set for the transaction (ie, to deliver the securities on time). However, SIX Swiss Exchange may, in special situations, in consultation with the Swiss Financial Market Supervisory Authority (FINMA), impose further restrictions on short-selling transactions. Although there are currently no such restrictions in effect, it should be noted that SIX Swiss Exchange enacted certain restrictions (notably a general prohibition of naked short sales) following the 2008 global financial crisis (which have been lifted in the meantime).

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

The OTC derivatives trading obligations are principally implemented through the Swiss Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading of 19 June 2015 (FMIA), which entered into force on 1 January 2016, as last amended with effect as of 1 January 2019. The FMIA is construed as a framework Act, which, in addition to the usual implementation powers granted to the Federal Council, provides for a comprehensive delegation of powers to the Federal Council as well as to FINMA, the regulator. Where a financial market infrastructure is of systemic relevance, the Swiss National Bank (SNB) has supervisory authority. With respect to derivatives trading, the FMIA imposes on Swiss counterparties a number of obligations, namely trade reporting; clearing; several risk-mitigation obligations, which include portfolio reconciliation, agreement on dispute resolution mechanism and the obligation to exchange collateral (initial margin and variation margin), for OTC derivatives transactions not subject to clearing; and yet to be enacted mandatory use of trade platforms.

The FMIA is supplemented by the Federal Council's Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading Ordinance (FMIO), FINMA's Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading Ordinance (FINMA-FMIO) and an amendment to the SNB's National Bank Ordinance (SNBO). The FMIO, FINMA-FMIO and the amended SNBO entered into force on 1 January 2016, all three as last amended with effect as of 1 January 2019, 1 September 2018 and 30 January 2018, respectively. The implementing ordinances FMIO and FINMA-FMIO, inter alia, specify which participant falls into which category of counterparty (by determining the respective threshold), to which categories of derivatives transactions the FMIA regulatory requirements shall apply (by defining such categories) and provide for a phase-in of the various regulatory requirements in respect of such derivatives categories.

On 6 July 2016, FINMA published Guidance 01/2016 to provide an update on the status and the next steps for the implementation of the FMIA, FMIO and FINMA-FMIO, and the authorisation and recognition processes. One of the main developments provided for in FINMA Guidance 01/2016 is the provisional recognition of the European regulations under the European Market Infrastructure Regulation (EMIR) and the FMIA. FINMA will carry out a full equivalence process to determine whether the conditions provided under the FMIO are met once the European regulations have been definitively passed. As of the date of this publication, FINMA has not indicated the likely timing of such confirmation. On 21 February 2019, FINMA published Guidance 01/2019, in which the derivatives regulations of the United Kingdom transposing EMIR into domestic UK law as a consequence of the United Kingdom leaving the European Union is provisionally recognised as being equivalent. The provisional recognition of equivalence will enter into force when the EMIR transposition act is passed by the British Parliament.

Following the publication of Regulation (EU) 2016/2251 on the exchange of collateral, FINMA published on 31 January 2017 Guidance 01/2017 to provide information about the schedule for the implementation of the Swiss regulations on the exchange of collateral.

On 3 April 2017, FINMA announced the authorisation of the first Swiss trade repository (SIX Trade Repository AG) and the recognition of the first foreign trade repository (Regis-TR SA) in Switzerland. This authorisation and recognition brought into effect the obligation of Swiss market participants to report their derivatives transactions to a trade repository (see question 9).

With effect as of 1 August 2017, the FMIO was revised with the aim of aligning the Swiss requirements regarding the implementation of the obligation to exchange collateral with the corresponding EU provisions (see question 25).

On 16 May 2018, FINMA published revised Annex 1 to the FMIO-FINMA and introduced mandatory clearing for standardised interest-rate and credit derivatives traded over the counter with a staggered implementation starting with the entry into force of the amended FMIO-FINMA on 1 September 2018 (see question 22 and 'Update and trends').

Compliance by financial and non-financial counterparties (see definitions in question 4) with the provisions of the FMIA will be monitored as part of the general compliance framework by their respective auditors. Auditors of financial counterparties must report any breaches to FINMA, who may then either address the issue as part of the overall supervisory process or initiate a formal enforcement procedure. If non-financial counterparties fail to take appropriate measures despite an auditor's notification, the auditors must report the infringements to the Federal Department of Finance (FDF). If a criminal provision of the FMIA has been breached, the FDF can initiate administrative criminal proceedings against financial and non-financial counterparties, leading to a fine of up to 100,000 Swiss francs.

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

There are no restrictions with respect to different types of entities that may enter into OTC equity derivatives transactions. However, some entities may fall within the scope of the FMIA when entering into equity derivatives transactions and, as a consequence thereof, such entities must comply with the obligations of the FMIA regarding derivatives trading. The FMIA imposes certain obligations on all counterparties having their registered seat in Switzerland that enter into derivatives transactions within the meaning of the FMIA and the FMIO. Foreign branches of Swiss counterparties are also in scope. Swiss branches of foreign counterparties are not in the scope of the FMIA, but may be subjected to the FMIA if they are not subject to any equivalent regulation in their home jurisdiction.

The personal scope of application under the FMIA is further based on the concept of different types of counterparties and distinguishes between financial and non-financial counterparties and in each case between minor and major counterparties.

Financial counterparties are counterparties that act in a professional capacity in the financial market as set out in an exhaustive list in the FMIA. This list includes banks, securities dealers, insurance and reinsurance companies, holding companies of financial or insurance groups and conglomerates, collective investment schemes, fund management companies and asset managers for collective investment schemes, pension funds and investment foundations.

A financial counterparty qualifies as a minor financial counterparty if its aggregate average gross position in all outstanding OTC derivatives transactions calculated on a rolling basis over 30 working days is below a threshold that is determined by the FMIO at 8 billion Swiss francs on a consolidated financial group level. The FMIO also provides for the method of calculating this threshold, which includes all outstanding derivatives transactions (ie, including hedging transactions, but not transactions specifically exempted from clearing under the FMIA) on a consolidated basis to arrive at a nominal gross average. If an existing minor financial counterparty's average gross position exceeds the threshold for four months, that counterparty will no longer be deemed minor.

Non-financial counterparties are counterparties that do not, according to the exhaustive list in the FMIA, qualify as financial counterparties. Minor non-financial counterparties are non-financial counterparties whose aggregate average gross position in each relevant outstanding OTC derivatives category calculated on a rolling basis over 30 working days is below the applicable threshold. The respective thresholds set out in the FMIO are, in line with EMIR, 1.1 billion Swiss francs for each of credit derivatives and equity derivatives and 3.3 billion Swiss francs for interest derivatives, currency derivatives, commodity derivatives and any other derivatives. Pursuant to the FMIA, derivatives transactions intended to reduce risks (hedging) are not considered in the calculation of such gross positions if they are directly associated with the business activity, liquidity management or asset management of the counterparty or group. The FMIO provides for detailed criteria for derivatives transactions to qualify for such an exemption. If any of the thresholds is exceeded for four months, the counterparty will no longer be deemed a minor counterparty.

The FMIA does not apply to all entities. Notably, it exempts the Swiss Confederation, the cantons and the municipalities, as well as the SNB and the Bank for International Settlement, from the scope of the rules on derivatives trading under the FMIA.

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?

As set out in question 3, the OTC derivatives trading obligations are principally implemented through the FMIA, FMIO, FINMA-FMIO and SNBO. These laws and regulations apply also to 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. FINMA, the SNB and the FDF are responsible for administering those rules. For the distinction between financial and non-financial counterparties, see question 4.

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?

Securities registration is a concept unknown in Switzerland. However, under the Swiss Code of Obligations, a prospectus must be prepared if newly issued equity securities are being offered to the public. Swiss courts have jurisdiction on claims (eg, prospectus liability claims) arising out of a public offering of newly issued securities in Switzerland. The prevailing view in Switzerland is that for the placement of existing equity securities from a strictly legal perspective no prospectus has to be prepared, even if such securities are offered to the public.

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

Swiss corporate law limits the right of a company to purchase and hold its own shares. A company and its subsidiaries may purchase its own shares only if and to the extent that: (i) it has freely distributable reserves in the amount of the purchase price; and (ii) the aggregate nominal value of all shares held by the company does not exceed 10 per cent of the company's share capital. The board of directors of a Swiss company is authorised to launch a share buy-back without prior approval of a shareholders' meeting. However, if the envisaged share buy-back is to exceed 10 per cent, the board of directors should seek approval for the share buy-back by the shareholders. In any event, the shareholders must approve the subsequent cancellation of the shares and the reduction of the company's share capital.

With respect to listed companies, in addition, the rules of FMIA, FMIO, FINMA-FMIO, the Ordinance of the Swiss Takeover Board of 21 August 2008 on Public Takeover Bids, as amended with effect as of 1 January 2016 to comply with the provisions of the FMIA, and certain Circulars of the Swiss Takeover Board (TOB), the regulatory body for takeover bids in Switzerland, apply.

In the Swiss market three types of share buy-backs are most commonly used. The predominant method is the share buy-back through a second trading line, where only the issuer (through a bank) offers a bid price on a separate trading line. Further, an issuer may repurchase its own shares by issuing put options (a right that grants the option to sell a certain quantity of shares at a specified price up to a specified date to the company) to its shareholders for free. The put options are tradable on the stock exchange typically for a period of 10 to 15 trading days. Both of these types of buy-backs are exclusively used for returning share capital to their investors, with a subsequent cancellation of the repurchased shares, and both of these buy-backs are subject to the Swiss withholding tax of 35 per cent, which is automatically deducted from the sales proceeds.

Moreover, an issuer may also repurchase shares on the main trading line if, for example, it repurchases such shares for an employee participation programme or, depending on the volume, an equity-linked programme, or it acquires shares for future mergers and acquisitions transactions payable in own shares. For tax reasons, the shares purchased on the main trading line may not be cancelled but must be transferred to an unrelated party within a specified period of time (six years).

Fixed-price offers by a listed company to purchase its own listed shares that are addressed publicly to the shareholders are deemed public takeover offers within the meaning of the FMIA. This also applies to public buy-back programmes at market prices (second trading line) or executed by issuing put options. However, in the TOB Circular No. 1, as last amended with effect as of 1 January 2016 to comply with the provisions of the FMIA, the TOB established simplified procedures for exempting buy-backs from the provisions of the Swiss takeover rules laid down in the FMIA (such as a request to the TOB for an exemption, where the programme, inter alia, does not exceed 10 per cent of either the capital or voting rights of the issuer; and 20 per cent of the issuer's free float).

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?

A dealer faces the credit risk of its counterparty and thereby the risk of a general creditor not to be paid or paid in full in the case of a bankruptcy or insolvency. The typical mitigants, such as netting and collateralisation, are available and, generally speaking, remain enforceable, including in cases of bankruptcy or insolvency. Netting, collateralisation and also portability of transactions and collateral are subject to specific protection in the case of cleared OTC equity derivatives if it involves a Swiss central counterparty (CCP). Where a counterparty is a Swiss bank or securities dealer, the Swiss Banking Act affords similar specific protection irrespective of the use of a CCP and also for uncleared OTC equity derivatives. FINMA may, however, under the Swiss Banking Act, order a temporary stay of termination or of the exercise of termination rights and of the exercise of netting, private realisation of collateral or porting rights of up to two business days in connection with its order of protective or restructuring measures against a Swiss bank or the Swiss branch of a foreign bank, where such termination or the exercise of the termination right would, under the terms of the relevant contract, be predicated on the order of such a protective or restructuring measure. This power of FINMA to stay termination applies not only to banks regulated under the Swiss Banking Act, but also to securities dealers regulated under the Swiss Stock Exchange Act and to financial market infrastructures regulated under the FMIA. The stay becomes permanent in respect of the particular protective or restructuring measure for which it was ordered if FINMA confirms that such measures that were coupled with the stay of a termination were successful in remedying the financial distress or violation of regulatory requirements.

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?

Trade reporting obligation

All financial and non-financial counterparties (with the exception of minor non-financial counterparties), as well as CCPs, shall report to a trade repository authorised or recognised by FINMA the material characteristics of all their open and new derivatives transactions (such as the identity of the parties entering into the transaction and the type, maturity, notional amount, settlement date and currency of the derivatives transaction, further specified in the FMIO) and any modification or termination thereof. This obligation applies to only one of the counterparties involved and may be delegated to a third party; the FMIA provides rules specifying which counterparty has to make such a report depending on the type of counterparties involved. Moreover, the reporting obligation also applies to intra-group transactions. Under the FMIA rules, the report shall be made at the latest on the day following the day on which the transaction has been concluded, amended or terminated.

On 3 April 2017, FINMA announced the authorisation of the first Swiss trade repository (SIX Trade Repository AG) and the recognition of the first foreign trade repository (Regis-TR SA) in Switzerland (FINMA Guidance 02/2017). This authorisation and recognition brought into effect the obligation of Swiss market participants to report their derivatives transactions to a trade repository. Under the FMIO's transitional rules, counterparties are obliged to report trades starting six, nine or 12 months after the first trade repository is authorised or recognised by FINMA, depending on the type of counterparty. The FMIO extends these deadlines by six months respectively for derivatives traded over trading venues (stock exchanges or multilateral trading facilities) or the operator of an organised trading facility. However, to give small non-financial counterparties (NFC) sufficient lead-in time for the technical implementation of the reporting obligation, FINMA has decided to extend the deadline to fulfil their reporting obligations in cases of derivatives transactions with foreign counterparties that do not report in accordance with the FMIA from 1 April 2018 to 1 January 2019 for OTC derivatives (FINMA Guidance 05/2017). On 14 September 2018, the Federal Council decided to further postpone the entry into effect of the reporting obligation for small NFCs until 1 January 2024, in line with international developments. The corresponding amendment to the FMIO entered into force on 1 January 2019. It is noteworthy that, at present, the recognition granted by FINMA to foreign trade repositories is restricted to the receipt of reports under Swiss law: foreign trade repositories are not yet recognised in Switzerland for the purpose of EMIR reporting. Consequently, it is not currently possible for Swiss market participants to make reports about derivatives transactions that are made to foreign trade repositories under EMIR and thereby to discharge the Swiss law reporting requirements by substituted compliance.

Reporting duty of participants where underlying equity of an equity derivative is listed on a Swiss trading venue

As an obligation that is independent of the reporting obligation to a trade repository, a Swiss securities dealer and other members of a Swiss trading venue must report to the Swiss trading venue at which the underlying equity is admitted any equity derivatives transaction, whether traded at the trading venue or outside the trading venue, in the same manner as the reporting of any direct trade in the underlying equity. The relevant underlying equities need not be equity securities listed or admitted to a trading venue, but can also be another exchange-traded product (eg, derivative or commodity); structured products are also in scope. FINMA Circular 2018/2 clarifies important aspects of this reporting duty. The obligation to report derivatives trades applies for all Swiss securities dealers as well as all foreign members of a Swiss trading venue.

Disclosure of significant shareholdings in listed companies

According to the FMIA, anyone who directly or indirectly, or acting in concert with third parties, acquires or disposes of shares or acquisition or sale rights relating to shares of a company with its registered office in Switzerland whose equity securities are listed in whole or in part in Switzerland, or of a company with its registered office abroad whose equity securities are mainly listed in whole or in part in Switzerland, and thereby reaches, falls below or exceeds the thresholds of 3 per cent, 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 33 per cent, 50 per cent or 66 per cent of the voting rights, whether exercisable or not, must notify this to the company and to the stock exchanges on which the equity securities are listed. The disclosure obligations are further specified in the FMIO and the FINMA-FMIO. In particular, as regards the disclosure of equity derivatives (ie, derivatives that have a value that is at least partially derived from the value or the performance of equity securities (of companies as described previously), which are (mainly) listed in Switzerland), the FINMA-FMIO provides that the disclosure obligations are triggered, inter alia, by the acquisition or disposal of conversion or acquisition rights (in particular call options) and by sale rights (in particular put options that provide for or allow actual delivery) if a disclosure threshold has been reached or crossed. On 14 February 2017, FINMA announced that it was changing the rules of the FINMA-FMIO regarding disclosure of significant shareholdings in listed companies with effect as of 1 March 2017. Under the new regime, positions held for the account of third parties can be aggregated at the level of the entity that has the discretionary authority to exercise the relevant voting rights (typically an asset manager) or at the level of the person who ultimately controls such entity. The new rules provide for a transition period of six months for implementation. Filings made prior to March 2017 are not grandfathered. Previous disclosures of client positions must have been updated by 31 August 2017.

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?

The FMIA provides for rules regarding insider trading and market manipulation, which provide for both criminal law and regulatory remedies. As a rule, these provisions also apply to financial instruments not admitted to trading on a regulated market in Switzerland (eg, OTC equity derivatives), but whose underlying value depends on a financial instrument admitted to trading on a trading venue in Switzerland, such as an exchange or a multilateral trading system.

Under the FMIA, insider information is qualified as any confidential information, the disclosure of which may substantially influence the value of securities admitted to trading on a trading venue in Switzerland. According to the regulatory provisions that apply to all market participants and go further than the criminal offences of insider trading and market manipulation (eg, no wilful intent is required), any person who has insider information and who knows or should know that it is insider information, or who has a recommendation that they know or should know is based on insider information, shall behave inadmissibly when this person:

- exploits it to acquire or dispose of securities admitted to trading on a trading venue in Switzerland or to use financial instruments derived from such securities;
- discloses it to another; or
- exploits it to recommend to another to acquire or dispose of securities admitted to trading on a trading venue in Switzerland or to use financial instruments derived from such securities.

However, the FMIO contains provisions regarding the admissible use of insider information, in particular in connection with securities transactions in preparation of a public takeover offer and a special legal status on the part of the recipient of the information.

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?

Generally, the counterparty must act in compliance with Swiss corporate law rules (eg, with respect to the provisions for the acquisition of treasury shares).

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

OTC equity derivatives are not, as such, taxable instruments for the purposes of the Swiss Stamp Tax Act, nor do they, as a rule, trigger withholding taxes under the Swiss Withholding Tax Act. It should be noted, though, that the Federal Tax Authority has, in certain instances, denied recovery of Swiss withholding taxes withheld from distributions made to the holder of a Swiss equity instrument, where such holder had entered into equity derivatives transactions (like a total return swap) passing on all or part of its risks and rewards in respect of such Swiss equity instrument to a third party, on the basis that owing to such transfer of risks and rewards, it did not view the formal holder of the Swiss equity instrument as its economic holder entitled to such recovery under the Swiss Withholding Tax Act or an applicable double taxation treaty with Switzerland. The Federal Supreme Court has confirmed this practice.

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

There is no particular liability regime in respect of OTC derivatives transactions generally, or OTC equity derivatives in particular. Therefore, liability derives from general principles and rules on contract or tort liability.

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

For the disclosure of significant shareholdings and the reporting duty of participants where underlying equity of an equity derivative is listed on a Swiss trading venue according to the FMIA (see question 9).

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

The typical documentation for OTC equity derivatives transactions is either the International Swaps and Derivatives Association (ISDA) documentation (ISDA Master Agreement, Schedule, credit support document and confirmations) or the Swiss OTC Master Agreement with its Credit Support Annex. ISDA has published a set of documents that will allow Swiss parties and their counterparties to implement the FMIA obligations, namely:

- the ISDA EMIR FMIA Top-up Agreement;
- the ISDA Regulatory Margin Self-Disclosure Letter;
- the ISDA 2016 Variation Margin Protocol; and
- the 2016 Credit Support Annex for Variation Margin.

In the context of OTC equity derivatives transactions, the parties may also use bespoke security documents in respect of the equity instruments underlying the equity derivatives transactions (eg, to avoid triggering disclosure obligations owing to the grant of a security interest in a Swiss listed equity instrument).

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

There is no standard practice. Typically, legal obligations are sought in connection with entering into a master agreement as such rather than in the context of entering into derivatives transactions. However, in the context of complex structured OTC equity derivatives transactions, seeking an enforceability opinion and, in the case of a listed underlying equity instrument, advice on disclosure obligations are quite common.

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?

As long as the company bears the risk with respect to shares that are formally held by a third party (because of a lending or repurchase transaction), the shares would have to be qualified as treasury shares of the company. Accordingly, such transactions may only be made to the extent that the company has freely distributable reserves and the aggregate nominal value of all shares lent by the company does not exceed 10 per cent of the company's share capital.

Generally, it is difficult to justify such lending or repurchase transactions unless they are in the interest of the company and, in addition, the company's duty to treat all shareholders equally is respected.

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?

Securities registration is an unknown concept in Switzerland (see question 6). No prospectus has to be prepared if a borrower pledges existing shareholdings. Further, a borrower must pledge the shareholdings in compliance with Swiss corporate and property law rules.

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?

Generally, when it comes to realisation of collateral on bankruptcy of a borrower that is an unregulated corporation, it is key to determine whether the assets being subject to a security interest are, due to the nature of that security interest, still to be regarded as assets being part of the bankruptcy estate of the borrower:

- assets over which the borrower has granted a regular pledge remain its property and would, in case of its bankruptcy, be part of the bankruptcy estate. In a bankruptcy, as a rule, a secured party is under an obligation to remit the pledged assets to the bankruptcy estate. The assets are liquidated by the receiver in bankruptcy in the same manner as the other assets of the bankruptcy estate, but the secured party retains its privilege to be satisfied from the proceeds of the liquidation of the assets pledged to it with priority over the unsecured creditors; and
- assets over which the borrower granted an irregular pledge or on a fiduciary basis are no longer deemed to be the property of the borrower, who merely retains contractual rights for the return of such assets, and based thereon, would in the event of its bankruptcy not be part of the bankruptcy estate. The realisation of such collateral would not be effected through the receiver in bankruptcy. The secured party would, hence, realise the collateral outside official realisation proceedings (ie, through private realisation but needs to account for the sales proceeds and remit any excess sales proceeds to the receiver in bankruptcy). Thus, accepting collateral by way of an irregular pledge is a common technique to prevent the security interest being part of the bankruptcy estate.

For banks and securities dealers, as well as for financial market infrastructures under the FMIA, private enforcement rights of collateral are specifically addressed and protected to the extent that the collateral's value can be objectively determined.

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

Exchange-traded derivatives are divided into those traded on a futures exchange, such as Eurex (options and futures), and those traded in a spot market, such as SIX Swiss Exchange Ltd (warrants and structured products).

All structured products admitted for SIX Swiss Exchange are traded on the SIX Swiss Exchange Ltd platform, and are subject to strict trading rules that ensure transparent and fair dealings for all market participants. Issuers and securities are admitted to trading under the regulated listing procedure of SIX Exchange Regulation. The products traded must fulfil clearly defined requirements to ensure investor protection.

According to the SIX Swiss Exchange Ltd monthly report of March 2019, the composition of products traded on SIX Swiss Exchange Ltd was as follows (the different types of products are described in the Swiss Derivative Map 2019, published by the Swiss Structured Products Association):

- 20,562 leverage products (such as warrants, spread warrants, warrants with knock-out, mini-futures, constant leverage certificates);
- 1,642 participation products (such as tracker certificates, outperformance certificates, bonus certificates, bonus outperformance certificates, twin-win certificates);
- 12,862 yield enhancement products (such as discount certificates, barrier discount certificates, reverse convertibles, barrier reverse convertibles, express certificates);
- 544 capital protection products (such as capital protection certificates with participation, convertible certificates, barrier capital protection certificates, capital protection certificates with coupon); and
- 323 investment products with reference entities (such as reference entity certificates with conditional capital protection, reference entity certificates with yield enhancement, reference entity certificates with participation).

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

On-exchange trading of options and futures on a futures exchange, such as Eurex, features standardised contracts (products) and the deposit of margins allow for smooth trading.

With respect to structured products that will be listed and traded on the SIX Swiss Exchange Ltd, generally, the SIX Swiss Exchange Listing Rules are applicable. In particular, the Additional Rules for the listing of Derivatives (ARD), Scheme F, the Directive on the Procedures for Debt Securities, the Directive on Debt Securities with Specific Structures and the Directive on Delisting of Equity Securities, Derivatives and Exchange Traded Products are applicable. Listing is restricted to products that relate to an underlying instrument that is admitted by the SIX Regulatory Board under the terms of articles 14 to 18 of the ARD, with a price that is set regularly and is publicly accessible. Further, the rules for trading are laid down, inter alia, in the SIX Swiss Exchange Ltd rule book and in additional directives.

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

The FMIA provides for a delegation to FINMA to determine the categories of derivatives to be cleared and the FINMA-FMIO sets out an exhaustive list of criteria to be adhered to by FINMA when making such determination, including, inter alia, the criteria set out in the FMIA (ie, the degree of legal and operational standardisation, liquidity, trade volume, information necessary for the formation of prices and counterparty risks). In addition, FINMA shall take into account recognised international standards and foreign legal developments when making such determination. FINMA has further detailed the criteria it would apply in the FINMA-FMIO. Annex 1 of the amended FMIO-FINMA entered into force on 1 September 2018. FINMA designated certain OTC standardised interest rate and credit derivatives (ie, interest rate swaps denominated in euros, pounds sterling, yen and US dollars. Implementation thereof is staggered over a period ranging from six to 18 months, depending on the counterparty classification. The mandatory clearing obligation has or will become effective at the following dates:

- as of 1 March 2019 for derivatives transactions concluded anew between clearing members of an authorised or recognised central counterparty;
- as of 1 September 2019 for derivatives transactions concluded anew between a clearing member and a large financial counterparty, r for derivatives transactions concluded anew between two large financial counterparties; and
- as of 1 March 2020 for all other derivatives transactions concluded anew.
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Under the FMIO, pension schemes and investment foundations have a temporary exemption from clearing for hedging transactions until 31 August 2019. The Federal Department of the Interior may further extend this deadline depending on international developments.

Financial and non-financial counterparties (with the exception of minor financial and minor non-financial counterparties) are obliged to clear their OTC derivatives transactions (ie, transactions in derivatives that were not conducted via a trading venue such as an exchange or a multilateral trading system) with a CCP authorised or recognised by FINMA. The Swiss Federal Council may also provide for mandatory clearing for derivatives that it would subject to mandatory trading on a trading venue, but has not done so to date. The clearing obligation applies also to derivatives transactions between a Swiss counterparty and a non-Swiss counterparty that would be subject to the clearing duty if it were located in Switzerland (ie, if its status as to the clearing obligation were to be determined under Swiss law). Additionally, the FMIA specifically states that no clearing obligation may be imposed, inter alia, for derivatives that are not actually cleared by any authorised or recognised CCP, for currency swaps and forward transactions provided that they are settled on a payment versus payment basis, or for intra-group transactions if two counterparties are fully consolidated members of a group, are subject to centralised risk-mitigation proceedings and the transactions do not aim at a circumvention of the mandatory clearing.

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

Financial and non-financial counterparties (with the exception of minor financial and minor non-financial counterparties) are obliged to trade their derivatives transactions over a platform authorised or recognised by FINMA. The FMIA provides for a later implementation in that the Federal Council will only determine the effective date of entering into effect of such obligation in light of international developments. The determination of the categories of derivatives subject to the obligation to trade over trading platforms is delegated to FINMA, while the FMIA provides for criteria to be adhered to when making such determination and exempts certain types of derivatives altogether. These provisions are similar to the FMIA criteria for the determination of categories of derivatives to be subjected to the clearing obligation (see question 22). According to its explanatory report, FINMA will not include such criteria in the FINMA-FMIO before the trading platform obligation has been enacted by the Federal Council as discussed above. Counterparties shall be obliged to make use of trading platforms starting six, nine or 12 months after a category of derivatives is subjected to such obligation by FINMA, depending on the type of counterparty.

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

The collateral arrangements for both cleared and uncleared equity derivatives may include a security interest in the underlying equity instruments. The margin requirements of a CCP as well as the margin requirements of the FMIA as part of the risk mitigation obligations for uncleared OTC equity derivatives transactions apply and call for variation margin and, as the case may be, initial margin (see question 25).

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

Non-standardised OTC derivatives transactions that are not mandatorily or voluntarily cleared with a CCP are subject to certain risk mitigation obligations set forth under the FMIA. Counterparties may in these cases be obliged to cover the counterparty risk through the exchange of collateral; mark-to-market the value of their outstanding transactions on a daily basis; and mitigate the operational risks arising from their derivatives transactions (ie, by confirming the terms of the derivative transaction in a timely manner, and implementing an appropriate process to reconcile portfolios, mitigating the associated risks and identifying and resolving disputes between the counterparties at an early stage). Such risk mitigation obligations apply to all financial and non-financial counterparties, with the exception of the obligation to mark-to-market outstanding transactions on a daily basis, which does not apply to minor financial and minor non-financial counterparties.

According to the FMIA, if counterparties (with the exception of minor non-financial counterparties) have to exchange appropriate collateral as part of the risk mitigation obligations, this shall take the form of an initial margin and, where applicable, the daily exchange of variation margin. With effect as of 1 August 2017, the FMIO was revised with the aim of aligning the Swiss requirements regarding the implementation of the obligation to exchange collateral with the corresponding EU provisions. The revised FMIO sets out specific requirements for the timely, accurate and appropriately segregated exchange of collateral, inter alia for the eligibility and the timing of the calculation and posting the initial and variation margins as well as for their thresholds and the relevant timeline for entry into force.

With respect to cross-border derivatives transactions, the FMIO provides that the obligation to exchange collateral shall also apply if the foreign counterparty of the Swiss counterparty, which is obliged to exchange collateral, would also be subject to this obligation if it had its registered office in Switzerland. As an exception, no collateral has to be exchanged if the foreign counterparty has its registered seat in a country whose legislation is recognised by FINMA as being equivalent and does not have to exchange collateral under the legislation of that country. In addition, the revised FMIO provides that a Swiss counterparty may choose not to provide initial and variation margin for cross-border transactions if:

- the foreign counterparty has its registered seat or is domiciled in a jurisdiction where the netting or collateral arrangement cannot be legally enforced; or
- where segregation does not correspond to internationally recognised standards.

Furthermore, the revised FMIO allows the Swiss counterparty to waive the provision of initial and variation margin by its foreign counterparty if either of the above conditions is fulfilled, and if:

- the reception of such margin in accordance with the FMIA and the FMIO is not possible; and
- the proportion, of all OTC derivatives transactions, of outstanding unsecured transactions entered into after the entering into force of the obligation to exchange collateral is less than 2.5 per cent.

The fulfilment of these conditions must be confirmed by an independent legal opinion.

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

The FMIA provisions apply both to derivatives transactions entered into between counterparties that are incorporated in Switzerland and to derivatives transactions entered into between a Swiss counterparty and a foreign counterparty. For instance, the obligation to clear with a CCP applies if the foreign counterparty of a Swiss counterparty, subject to the clearing obligation, would itself be subject to the clearing obligation if it were established in Switzerland. However, recognised foreign market infrastructures can be used by Swiss counterparties to discharge their obligations in connection with derivatives transactions under the FMIA if the relevant market infrastructure is recognised and if the foreign law is recognised as being equivalent to Swiss law.

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

No registration or authorisation requirements apply to market participants that deal or invest in equity derivatives in Switzerland.

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

See question 9.

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?

Under Swiss law, a distinction has to be made between plain vanilla notes and 'structured products'. Structured products are commonly described as investment instruments for which the redemption value is linked to the performance of one or more underlying values. Products where the primary focus is on investment purposes (and not on financing the issuer) qualify under Swiss law as structured products. The Swiss Federal Act on Collective Investment Schemes dated 23 June 2006, as amended (CISA), contains, inter alia, specific provisions regarding the offering of structured products. In this respect, it should be noted that the CISA does not provide for a clear-cut definition of the term 'structured product'. Rather, the CISA simply lists a number of examples for structured products (eg, capital-protected products, capped return products and certificates). For this reason, whether a product is considered to be a structured product within the meaning of the CISA has to be assessed on a case-by-case basis. However, if the structured products are linked to any collective investment schemes, the rules of the CISA regarding the distribution of collective investment schemes may be applicable (under specific circumstances).

The distribution of structured products exclusively to qualified investors within the meaning of the CISA (eg, banks, securities dealers, insurance companies, asset managers of collective investment schemes, fund management companies, pension funds and corporates with professional treasury management), or otherwise in a manner that does not constitute distribution within the meaning of the CISA in Switzerland, falls outside the scope of the CISA and is, as such, not subject to regulatory restrictions or requirements under the CISA.

Conversely, structured products may only be distributed in or from Switzerland to non-qualified investors (ie, retail investors) if they are issued, guaranteed or backed with equivalent sureties by either a Swiss bank, a Swiss insurance company, a Swiss securities dealer (a Swiss institution) or a foreign institution that is subject to equivalent standards of supervision (a foreign institution). Therefore, structured products issued by a non-Swiss issuer who is not subject to equivalent standards of supervision could be distributed in or into Switzerland to non-qualified investors, provided that such structured products are guaranteed by a foreign institution.

In all cases and in the absence of a listing on a Swiss stock exchange, a Swiss simplified prospectus (SSP) within the meaning of the CISA must be available when offering structured products to non-qualified investors in Switzerland. The SSP can be described as a longer version of a long-form key investor information document, which does not have to be filed or registered. The general content requirements of an SSP are set out in the Swiss Banking and Swiss Structured Products Association guidelines on informing investors about structured products of September 2014. If the structured products are to be listed on the SIX Swiss Exchange, the detailed listing rules of the exchange must be complied with and the prospectus must be filed with and approved by the listing board of the exchange.

For a foreign institution to be permitted to distribute (non-listed) structured products to non-qualified investors in Switzerland it must maintain an office in Switzerland, which may be a Swiss-licensed representative office, branch office or subsidiary, sister company or a group company, provided that such a company is under consolidated supervision at group level. The role of such presence in Switzerland is limited to the task to make the relevant SSP available to interested investors.

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

Non-compliance with Swiss statutory prospectus requirements in an SSP for the distribution of structured products in, into or from Switzerland is enforced under Swiss law through civil and criminal prospectus liability.

One of the first civil law risks that the issuer may face for an incorrect, incomplete or misleading SSP is the regress of a Swiss bank or a Swiss securities dealer having been sued by their clients. It could be considered that the grounds of such civil liability would be a violation of the subscription or purchase agreement entered into between the issuer and a Swiss bank or a Swiss securities dealer (eg, a violation of a

Update and trends

After the authorisation of the first Swiss trade repository and the recognition of the first foreign trade repository in Switzerland on 3 April 2017, bringing into effect the obligation of Swiss market participants to report their derivatives transactions to a trade repository, FINMA had extended the deadline for small non-financial counterparties from 1 April 2018 to 1 January 2019. On 14 September 2018, the Federal Council decided to further postpone the entry into effect of the reporting obligation for small NFCs until 1 January 2024, in line with international developments. The corresponding amendment to the FMIO entered into force on 1 January 2019.

On 1 September 2018, Annex 1 to the revised FMIO-FINMA entered into force, introducing mandatory clearing for standardised interest-rate and credit derivatives traded over the counter.

In February 2019, FINMA published Guidance 01/2019, in which the derivatives regulations of the United Kingdom transposing EMIR into domestic UK law as a consequence of the United Kingdom leaving the European Union, is provisionally recognised as being equivalent. The provisional recognition of equivalence will enter into force when the EMIR transposition act is passed by the British Parliament.

We note that an amendment to EMIR has recently been decided at European level (EMIR 2.1). To date, the FDF has not announced, to what extent and in which form the amendment will be implemented into Swiss law.

representation and warranty of the issuer pursuant to which the SSP is complete and contains all the required information (contractual liability)). Such civil liability risk of the issuer would, potentially, be limited and reduced by the obligation of the Swiss bank or Swiss securities dealer, as FINMA supervised financial institutions, to control the compliance of the SSP with the applicable rules before distributing such a document to their clients.

A second civil law risk that the issuer faces for an incorrect, incomplete or misleading SSP, regardless of the specific applicable legal civil liability basis – being either article 752 or 1156 of the Swiss Code of Obligations, or a liability based on reliance (prospectus liability) – derives from a direct litigation initiated by the end client claiming that an SSP is incorrect, incomplete or misleading, provided that the conditions of damage, causation and negligence are established.

The CISA provides that it is a criminal offence to infringe the provisions governing the statutory prospectus requirements.

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?

A company may issue convertible or exchangeable bonds (ie, debt instruments that are issued either by the listed company itself or a wholly owned subsidiary (typically an offshore special purpose vehicle for tax purposes) and are convertible or exchangeable into shares of the relevant listed company). The shares to be delivered on conversion may be new shares issued from conditional share capital of the issuing company or the relevant Swiss parent company. Subject to the terms of the bonds and availability of treasury shares, treasury shares could also be delivered on conversion (subject to certain restrictions).

Unless the relevant existing articles of association already provide for conditional share capital to be used for the issue of convertible bonds under the exclusion of the existing shareholders' advanced subscription rights (which are in proportion to their shareholding), the creation of conditional share capital (up to a maximum of 50 per cent of the existing share capital) requires a resolution of a shareholders' meeting passed with two-thirds of the votes represented at the meeting and an absolute majority of the nominal value of the shares represented by way of an amendment to the company's articles of association, which must outline the basic terms of the conditional share capital and its purpose. Any convertible bonds must first be offered to the shareholders for subscription unless a resolution by the shareholders' meeting limits or excludes the pre-emptive rights of the existing shareholders as to such convertible bonds or authorises the company's board of directors to limit or exclude such pre-emptive rights based on a valid reason (eg, an acquisition of a business or parts of a business).

It is common to formally list the conditional share capital right after the issue of the relevant convertible bond. No listing prospectus is necessary if such shares are of the same type and class as the shares already listed and the new listing relates to less than 10 per cent of the shares already listed.

Under the assumption that the issuer is a resident of Switzerland for tax purposes and that the (mandatory) convertible bond will qualify as a bond for tax purposes (and not as a mere loan convertible into shares that, as a rule, do not trigger Swiss withholding tax on interest payments or Swiss stamp tax on the granting of the loan), any interests made (prior to the conversion) by the issuer to its bondholders are subject to Swiss federal withholding tax imposed on the gross amount at the current rate of 35 per cent. Non-Swiss resident beneficiaries of interest payments in respect of the bonds may be entitled to a partial or full refund of the withholding tax in accordance with the applicable double taxation treaty between Switzerland and the beneficiary's country of tax residence or the relevant agreement regarding the

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automatic exchange of information in tax matters between the EU and Switzerland, to the extent applicable.

As a general rule, convertible bonds issued by a non-Swiss subsidiary and guaranteed by its Swiss parent company are treated as non-Swiss convertible bonds for tax purposes if the proceeds of such bonds do not flow back to Switzerland. Interest paid on non-Swiss convertible bonds is, as a rule, not subject to Swiss federal withholding tax.

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?

See question 31.

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