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The Duty to Disclose Significant Holdings in Listed Companies – the Federal Banking Commission Tightens the Regime

As of 1 July 2007, two important changes regarding the duty to disclose significant holdings in listed companies have entered into force: First, a holder of equity securities has to add all (call) options he holds to his holdings in shares in order to determine whether a threshold triggering the disclosure duty has been reached. Second, options providing for cash settlement are subject to the disclosure duty.

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Background: OC Oerlikon Corporation AG and Saurer AG

Pursuant to Art. 20 al. 1 of the Stock Exchange Act (SESTA), the holder of a significant interest in a Swiss company whose equity securities are listed in Switzerland is required to notify the relevant company and the stock exchange on which its securities are listed if the holding reaches, exceeds or falls below the thresholds of 5%, 10%, 20%, 33 1/3%, 50% and 66 2/3% of the voting rights of the listed company.

In autumn 2006, OC Oerlikon Corporation AG (Oerlikon) published a public tender offer for all of the shares of Saurer AG (Saurer). On the day the offer was pre-announced, Oerlikon already held 24.1% of Sauer's shares and call options on an additional 26.1%, a total stake of slightly more than 50% in the target company. Even though the disclosure duty pursuant to Art. 20 SESTA arises when a person acquires shares representing 5% of the voting rights in a listed company, Oerlikon had managed to acquire an almost controlling stake in Saurer without triggering the disclosure duty by using a tailor-made option strategy with the assistance of a bank.

Under the legal framework in force at that time, the acquisition or sale of call options was only subject to the disclosure duty if the options allowed, or provided for, physical settlement. In addition, Art.13 al. 3 of the Stock Exchange Ordinance of the Federal Banking Commission (SESTO-FBC) contained an exemption for call options on shares representing less than 5% of the voting rights of the company, regardless of the current interest of the acquirer in shares. Thus, an investor could hold shares representing up to 4.9% of the company's voting rights and options on shares representing a further 4,9% of the voting rights without being required to notify the holdings.

Legislative Action Taken by the Parliament

The Saurer case and some similar cases in which foreign investors disclosed their acquisition of large holdings composed of shares and options in Swiss companies without making initial notifications at the 5% or 10% thresholds – such as Victory Industriebeteiligungen AG's investments in the former Unaxis and Ascom Holding AG and, most recently, Everest Beteiligungs GmbH's investment in Sulzer AG – prompted legislative action by the Parliament. The National Council (NC) proposed the following amendments to the disclosure duty in order to prevent an investor from silently acquiring an almost controlling stake in a target company:

(i) the reduction of the initial reporting threshold from 5% to 3% and the introduction of additional reporting thresholds when 15% and 25% of the voting rights of a listed company are reached;
(ii) the addition of all (call) options to the holdings of shares when determining whether a reporting threshold has been reached; and
(iii) the introduction of an additional sanction – in addition to fines – for violating the disclosure duty, by giving a civil judge the power to suspend the voting rights of an investor who violated the disclosure requirements.

In April 2007, the State Council (SC) approved these proposals, but declined to introduce them as an urgent law (Dringlichkeitsrecht). Thus, they are expected to enter into force shortly after the referendum period elapses, possibly around the beginning of 2008, depending on how fast the NC and the SC are able to resolve their remaining differences.

Immediate Steps Taken by the FBC: Amendments Entered in Force per 1 July 2007

The Federal Banking Commission (FBC) took the view that some changes to the disclosure duty had to be

adopted as a matter of urgency and proposed amendments of the disclosure duty in the SESTO-FBC. In particular, the FBC proposed to:

(1) extend the disclosure duty to the acquisition and sale of put options;
(2) extend the disclosure duty to the *issuance* of conversion and acquisition rights, particularly of call options;
(3) abolish the exemption limit with regard to the holdings in options stated in Art. 13 al. 3 SESTO-FBC; and
(4) immediately make cash settlement options subject to the disclosure duty.

After certain participants in the consultation procedure criticised the FBC's intention to make the issuance of call options and the acquisition of put options subject to the disclosure duty, the FBC decided to refrain from implementing its proposals listed in paragraphs (1) and (2) above, and to have them discussed in the context of the upcoming revision of the SESTA. Nonetheless, the changes mentioned in paragraphs (3) and (4) enter into force on 1 July 2007. Accordingly, whoever holds equity securities in a listed company is obliged to add his (call) options to the holding in shares in order to determine whether the disclosure duty is triggered. Furthermore, options providing only for cash settlement must now be treated in the same way as options providing for physical settlement.

First Difficulties and Prospects

A first difficulty arising from the two amendments introduced by the FBC is that the FBC has decided not to grant an adequate transition period for their application and has, on 22 June 2007, declared them applicable as of 1 July 2007. This means, that all investors who (i) either reach a relevant threshold or (ii) have to amend their current disclosure notification due to these legislative changes even without having made a transaction in shares or options of the relevant company will have had to do so within four trading days after 1 July 2007, e.g. on 5 July 2007 at the latest. Furthermore, investors, particularly institutional investors such as banks, insurance companies and pension funds, may need to adapt their internal reporting systems covering their transactions in shares and options of listed companies in order to detect whether the disclosure duty has been triggered.

In view of the above, the trend regarding the disclosure duty is clear. The tightened regime for the treatment of transactions in options is just the first step on the way to a generally more stringent regime. Apart from the changes contemplated by the Parliament, it is clear that the FBC intends to act more vigorously if the disclosure duty has been, or seems to have been, violated. Recently, the FBC also stated that, in its view, even the extended sanction mechanism for violations of the disclosure duty is not sufficient. However, it remains to be seen whether the currently pursued direction will have the desired effects and strengthen the Swiss financial and securities market.

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