Combating market abuse: the new Swiss circular on market behavior: regulatory challenges for fair financial markets

WEBER, Rolf H., DARBEILLAY, Aline


Available at: http://archive-ouverte.unige.ch/unige:94733

Disclaimer: layout of this document may differ from the published version.
Combating Market Abuse: The New Swiss Circular on Market Behavior
Regulatory Challenges for Fair Financial Markets
By Prof. Dr. Rolf H. Weber and MLaw Aline Darbellay*

The Circular on Market Behavior entered into force on May 1, 2008. The Federal Banking Commission (FBC) had already developed a practice to combat market abuse based on the assurance of proper business conduct. The guidelines (constituting a shortened version of a heavily criticized draft of 2003) are, therefore, primarily intended to clarify the existing practice. Moreover, the FBC strives to improve the administrative enforcement of market abuse in Switzerland. The importance of tackling market misconduct is especially recognized by the investing community.

This paper emphasizes the central aspects of the new guidelines in the light of the European market abuse regime. The Circular establishes improved clarity in respect of the material criteria which involve market abuse cases, considered as a distortion which occurs if certain market participants behave in a deceiving manner. Therefore, the primary task consists in defining what embodies an abusive practice in the financial markets. Furthermore, the promotion of a fair market behavior should be linked to the FBC's possibilities of action against infringements of the law.

Table of Contents

I. The Evolution of Market Abuse Provisions over the Past Decade
   1. The Requirement of Correct Behavior to Supply Market Integrity
      1.1 The Benefit of Competitive Markets
      1.2 The Protection of Investor Confidence in Financial Markets
      1.3 The Regulatory Issues against Market Abuse in Legal Frameworks
   2. The Practice of the Federal Banking Commission to Combat Market Misconduct
      2.1 The Basis for Actions of the Federal Banking Commission and the Instruments at its Disposal
      2.2 Biber as the Leading Case to Approve the Practice of the Federal Banking Commission
      2.3 The Difficulties to Detect and Prosecute Market Abuse
   3. The First Proposed FBC Circular on Market Abuse and its Withdrawal due to the Opposition from the Financial Industry
      3.1 The Proposals for Administrative Guidelines to Lay Down the Previous Practice
      3.2 The Argued Reasons for the Negative Reactions in the Financial Sector
II. The FBC Circular on Market Behavior
   1. The Context of the Guidelines on Market Behavior and the Achieved Results
   2. The Central Characteristics of the Guidelines on Market Behavior
   3. The Prohibition of Various Forms of Market Abuse
      3.1 The Information Abuse
      3.2 The Market Manipulation
      3.3 The Dissemination of False, Incomplete or Misleading Information
      3.4 The Principle of Good Faith
   4. The Accepted Market Practices

5. Selected Topics from the Organizational Obligations of Financial Services Providers
   5.1 Introducing Organizational Measures in General
   5.2 Dealing with Conflicts of Interest
   5.3 Establishing Chinese Walls
   5.4 Controlling the Employees' Transactions
6. Summary of the Amendments to the Previously Intended Circular on Market Abuse

III. Proposals for Improvement
   1. The Need for Action to Enhance the Consistence of the Market Abuse Regime
   2. The Promotion of Prompt Disclosure of Inside Information
   3. The Duty to Report Suspicious Transactions

IV. Concluding Remarks

I. The Evolution of Market Abuse Provisions over the Past Decade

1. The Requirement of Correct Behavior to Supply Market Integrity

1.1 The Benefit of Competitive Markets

Since financial markets play a prominent role in the efficient allocation of capital resources, they participate in the economic growth of the modern world and have to be vested with a certain degree of legitimacy.¹ The shortage of private investments due to fraudulent behavior may even threaten financial stability. Furthermore, market conditions deserve particular attention in a context in which competition developments presumably have significant effects on


* The authors would like to thank Prof. Christine Kaufmann, Prof. Alexander Wagner, Dr. iur. Thomas Liel and lic. iur. Valérie Menoud for their valuable comments to an earlier version of this paper.
social welfare. Fraudulent behavior can negatively affect the markets and is susceptible to decrease their competitiveness.

The release of basic rules which incentivize correct market conduct is therefore fundamental in view of preventing fraud from tarnishing the reputation of the financial markets. Promoting market discipline implies, more particularly, that an identical treatment applies to each potential investor. Precluding insiders from taking advantage of their specific position represents a key issue in competitive financial markets. However, the aim of regulation cannot be an absolute equality among market participants; rather, sufficient access to material information shall be provided to the market participants, giving equal chances and adequate incentives. This approach eventually contributes to enhancing competition in financial markets.

1.2 The Protection of Investor Confidence in Financial Markets

Market abuse is the largest destroyer of investor confidence and therefore a powerful enemy of market efficiency. Broadly speaking, market abuse involves a distortion in the financial markets resulting from the deceiving behavior of certain market participants. The protection of investors requires attention since their confidence in the integrity of the financial markets serves the purpose of market efficiency. Nevertheless, from an economic point of view, it would be a mistake to protect investors against every loss resulting from their (risky) activities. Insofar as market actors take risks to achieve a higher return, they should also be prepared to face losses.

Fairness in trading, however, is a central issue of financial markets’ reliability. Market supervision should ensure the proper functioning of the financial markets. If investors can satisfyingly rely on the markets, they will engage more confidently in transactions. Moreover, certain information must be given to the investors in order for them to dispose of a sufficient basis to trade; the system reassures the investors on markets’ integrity while guaranteeing an adequate level of transparency.

1.3 The Regulatory Issues against Market Abuse in Legal Frameworks

Since financial markets are vulnerable to unfair trading practices, the main goal of regulatory activism must be to ensure ethical conduct in dealing with securities. Financial laws should be designed to preserve and promote investors’ confidence in the integrity of the markets, be it through the means of criminal law or through other mechanisms like supervisory law. The challenge consists in achieving effective deterrence of market abuse as well as fair punishment of financial actors who compromise the reputation of the financial markets.

Accordingly, regulatory rules prosecuting market abuse have been introduced in most financial centers of the Western world. The US Sarbanes-Oxley Act came into force to restore investor confidence in the integrity of financial markets after scandals due to the failure of large American firms. The UK’s Financial Services and Markets Act and the EC Market Abuse Directive were also brought into effect to provide

---

2 Jacob A. Bikker, Competition and Efficiency in a Unified European Banking Market, Cheltenham and Northampton 2004, p. 3.
3 Ralph Malaercida, New Market Misconduct Rules for virt-x Participants – Will the Swiss have to Play Cricket?, AJP 2001, p. 802.
6 See Art. 5 of the Swiss Federal Act of June 22, 2007 on Financial Market Supervision (FINMA Act); this law will integrally come into force on January 1, 2009.
10 Avgouleas (n. 1), p. 6.
sufficient protection for the markets and counter confidence losses caused by financial fraud.

In Switzerland, the above-mentioned trend has exerted influence on the Federal Banking Commission (FBC), which is the financial authority empowered with the administrative enforcement of measures against fraudulent behavior in the financial markets. On May 1, 2008, the FBC brought the Circular on Market Behavior Rules for the Securities Market into force. Its primary objective consists in the attempt to formally introduce practices that it had already been developing regarding market abuse in the past.

2. The Practice of the Federal Banking Commission to Combat Market Misconduct

2.1 The Basis for Actions of the Federal Banking Commission and the Instruments at its Disposal

The FBC is competent to tackle fraudulent behavior in the financial markets pursuant to its supervisory function. The actions taken are based on the required assurance of proper business conduct by the financial actors, which is anchored in Art. 3 paragraph 2 lit. c of the Banking Act and Art. 10 paragraph 2 lit. d of the Stock Exchange Act.

The administrative enforcement through the supervisory authority is carried out along with the criminal provisions in Art. 161 and Art. 161bis of the Swiss Criminal Code, i.e. the administrative prohibitions play an autonomous role alongside the criminal laws' requirements. Since not only crimes are able to jeopardize confidence, integrity and efficiency in financial markets, the supervisory practice of the FBC goes beyond the scope of the criminal provisions and covers a wider range of activities.

Nevertheless, there is a need for collaboration between the FBC and the various authorities for criminal prosecution. In fact, the supervisory authority has no power to impose a penalty on market participants; once it observes a market misconduct which falls under the scope of criminal law, it must immediately advise the competent criminal authority, which will eventually start investigations against the potentially liable persons.

So far, the FBC is confronted with a restricted possibility of action because of the limited instruments at its disposal. If financial services providers fail to comply with their duties, the supervisory authority comes too late with preventive measures. It may only give instructions to the regulated companies in order that they adopt a proper conduct in the future. In serious cases, it has the possibility to withdraw the banking license, which appears as an ultima ratio.

2.2 Biber as the Leading Case to Approve the Practice of the Federal Banking Commission

Biber has been the leading case in which the Federal Supreme Court recognized the practice developed by the FBC to combat market abuse. Three banks were realizing a project for the purpose of helping Biber Holding Ltd to improve its financial situation. When the involved banks sold shares of this company, however, they had a privileged knowledge about its financial problems and presumably knew that the company would eventually fail; at least, they knew that the real value of the shares was clearly under the market price. By deferring a substantial part of the enterprises' losses to the shareholders, they misused information that was not publicly available, and therefore acted against investors' interests.

---

14 The FBC will be integrated into the authority for financial market supervision FINMA (see Art. 1 of the FINMA Act).


16 Einwandfreie Geschäftsleitung, activité irréprochable.

17 Swiss Federal Act of November 8, 1934 on Banks and Savings Banks (Banking Act).


19 FBC, Annual Report 2001 (German Version), p. 75; FBC, Annual Report 2007 (German Version), p. 21; see also for the FSMA market abuse regime Edward J. Swan, Market Abuse Regulation, Richmond 2006, p. 159.

20 See further FBC, Annual Report 1999 (German version), pp. 86–87.

21 Art. 35 paragraph 6 of the Stock Exchange Act; see further FBC, Annual report 2003 (German version), p. 103; see also FBC, Annual report 2005 (German version), pp. 88–89; see also FBC, Annual Report 2006 (German version), p. 68.

22 FBC, EBK-Sanktionsbericht, April 2003, p. 17.

23 Art. 36 of the Stock Exchange Act (relating to its amendment due to the coming into force of the FINMA, see BBl 2007, p. 4661).

The FBC condemned the behavior of the aforementioned banks since it contradicted the assurance of proper business conduct as laid down in Art. 3 paragraph 2 lit. c of the Banking Act and Art. 10 paragraph 2 lit. d of the Stock Exchange Act. In fact, the financial services providers must take the interests of their investors into account; in addition, they also have to assume responsibility for ensuring the trustworthiness of the Swiss financial center in general. The FBC’s conclusions were approved by the decision of the Federal Supreme Court, which thus legitimated the previous practice of the administrative authority.

In the light of the FBC's practice, market abuse is classified in four categories: First, in order to avoid information abuse, conduct rules prevent the fraudulent exploitation of inside knowledge by the market actors. Second, market manipulation is seen as a distortion which must be combated in order to maintain fairness and competitiveness in the financial markets. Third, the dissemination of false, incomplete or misleading information is another type of misbehavior which harms the markets. Fourth, other market misconduct can be qualified as market abuse by the FBC, enabling the supervisory authority to intervene against further kinds of misbehavior.

2.3 The Difficulties to Detect and Prosecute Market Abuse

A major challenge for a proper supervision consists in detecting market abuse. The Swiss Stock Exchange performs the basic tasks of surveillance of the financial markets; this organization informs the FBC about a potential fraud committed by market actors. Subsequently, the FBC examines the reported cases for any indication of market misconduct. The investigation is extremely demanding. Even if fraudulent behavior is suspected, major difficulties arise from the fact that infringements are often difficult to prove.

Over the past decade, there have been many cases in which the FBC had to close the proceedings due to lack of proof. Only few of the cases reported by the Swiss Stock Exchange to the FBC as suspicions of market abuse have resulted in final administrative-criminal judgements so far. In most cases, the supervisory authority abandoned the prosecution without declaring any market abuse.

3. The First Proposed FBC Circular on Market Abuse and its Withdrawal due to the Opposition from the Financial Industry

3.1 The Proposals for Administrative Guidelines to Lay Down the Previous Practice

In 2003, the FBC decided to release guidelines on market abuse. A draft for such guidelines was published for comments. The aim of the proposed Circular was to describe the practice that the supervisory authority had developed so far. It should have been a guidance intended for the market actors to get a clearer idea of the required behavior in the financial markets.

The FBC maintained the four categories of market abuse as described in its practice. The classification was as follows:

- **Abuse of information**: Market players are banned from misusing information that is not publicly available and price-sensitive.
- **Market manipulation**: Transactions and orders constitute market abuse if giving a false impression of market activity as well as if distorting the demand, the supply, the market price or the value of securities.
- **Misleading of the market**: It is prohibited to disseminate false, incomplete or misleading information.
- **Other market misconduct**: This last form is a “catch-all” category for other abusive conduct that damage the financial markets.

---

25 FBC, Annual Report 2001 (German version), p. 76.
26 Art. 6 paragraphs 1–2 of the Stock Exchange Act.
27 See for further concerns FBC, Annual Report 1999 (German version), p. 88; see also FBC, Annual Report 2000 (German version), pp. 80–81.
28 FBC, Annual Report 1999 (German version), p. 88; FBC, Annual Report 2000 (German version), p. 81.
30 FBC, Annual Report 2003 (German version), p. 93.
31 Draft Circular on Market Abuse (n. 29), paragraph 10.
32 Draft Circular on Market Abuse (n. 29), paragraph 26.
33 Draft Circular on Market Abuse (n. 29), paragraph 43.
34 Draft Circular on Market Abuse (n. 29), paragraph 52.
3.2 The Argued Reasons for the Negative Reactions in the Financial Sector

Vehement criticism led the FBC to drop the project. What emerged from the consultation was broadly the reproach of over-regulation. According to the opinion of market participants, the planned guidelines went further than the legal frameworks abroad. Overriding the rules of the neighbor countries may have jeopardized the competitiveness of the Swiss financial markets.

Furthermore, emphasis was put on the value of self-regulation. Market participants claimed that the FBC would neglect private developments by reducing excessively the liberty of the financial sector. Regulatory activism should rather play a role in safeguarding an appropriate sphere of influence for the private actors.

The most criticized part of the planned Circular was the fourth category of market abuse. Allowing the prosecution of other forms of market abuse would lead to uncertainty, a disadvantage on the shoulders of the market participants. Market abuse would deserve a precise definition not permitting any vagueness. Therefore, the financial sector recommended the supervisory authority to simply withdraw this aspect of market abuse.

However, the financial sector recognized the need for action to prevent fraud from damaging the financial markets. It especially appreciated the efforts of the FBC to increase confidence and transparency in the markets.

II. The FBC Circular on Market Behavior

1. The Context of the Guidelines on Market Behavior and the Achieved Results

Realizing the rejection of the Circular on Market Abuse, the FBC exchanged ideas with the interested financial circles. In 2005, it declared to be able to resume the project. In November 2007, the supervisory authority opened a consultation procedure for the revised version of the guidelines, which was renamed Circular on Market Behavior in order to emphasize the undertaken amendments.

The consultation resulted in wide acceptance among the market participants. They basically welcomed the amended guidelines, namely the shortening of the project, the establishment of the material criteria constitutive for market abuse and the presence of accepted market practices.

In fact, the revised guidelines represent a soft version of the former Circular on Market Abuse. In this sense, the supervisory authority considered the criticism provided by the financial sector. However, the FBC did not substantially deviate from its previous substantive positions. The Circular entered into force on May 1, 2008.

2. The Central Characteristics of the Guidelines on Market Behavior

   - The Scope of Application

Concern has especially been raised about the personal scope of application of the Circular. Broadly speaking, the guidelines on market behavior apply to the participants of the regulated financial markets; insofar the Circular is indeed linked to the prudential regulation of financial actors.

The Circular primarily covers the market participants who fall under the Stock Exchange Act, such as securities dealers and investment banks. These actors also assume responsibility while acting for a client’s account; if there is an indication of abusive practice on the part of the client in question, they should abstain from engaging in the transaction. This obligation is due to the fact that not every client falls within the scope of the Circular. Hence, some market participants are only indirectly concerned by the administrative market abuse regime; for instance, several categories of investors such as pension funds and insurance companies are not regulated under the Stock Exchange Act.

36 Consultation on the modification drafts concerning the Circular on Market Behavior, January 2008; the comments are available on the Internet at http://www.ebk.admin.ch/e/regulier/stellungnahmen.html.
37 Circular on Market Behavior (n. 15), paragraphs 4-6.
38 Circular on Market Behavior (n. 15), paragraph 4.
39 Circular on Market Behavior (n. 15), paragraph 5.
40 Nevertheless, the market participants who do not fall under the scope of the Circular are targeted by the criminal provisions of the Swiss Criminal Code.
To some extent, the application of the guidelines is connected with several institutions regulated by the Banking Act as well as by the Collective Investment Schemes Act.41 In this context, there is a particularity for banks without the status of securities dealers and for fund managers who hold a license under Art. 13 paragraph 2 lit. a, b, c, d and f as well as paragraph 4 of the Collective Investment Schemes Act: If these market participants deal with securities for their own account or for the account of third parties, they have to follow the conduct rules against market abuse; yet they have no organizational obligations to accomplish.42

- The Principle Based Regulation

In accordance with the Swiss conception of financial laws, the guidelines on market behavior limit themselves to enshrining principles.43 Instead of stating every detail, they grant discretion to the financial sector. Since one size does not fit all, the purpose of the target guidelines solely consists in elaborating basic standards supplemented by the market actors.

The Swiss tradition of self-regulation has to be respected due to the valuable and essential contribution of the private organizations to the regulatory system.44 More than creating detailed rules of conduct, the legal framework should help the self-regulatory bodies in developing their own rules to prevent fraud from harming the financial sector.

Consequently, the FBC has shortened its Circular by half to follow the request of the financial sector. This concise version shall respond to the expectations of the concerned circles, eliminating the unnecessary contents.

- The Positive Description of the Required Market Conduct

The guidelines specify what embodies a correct behavior in the financial markets instead of combating market abuse offense directly.45 This approach reveals the fact that the targeted Circular aims at giving an idea of the appropriate conduct in the markets without punishing bad practice. In fact, the heading and the first sentence of each category attest the willingness of the FBC to promote fair behavior among market participants. Even the title of the guidelines was changed from Circular on Market Abuse to Circular on Market Behavior. This approach contributes to softening the framework.

Therefore, if the market players fail to accomplish their duties, considerable consequences do not necessarily arise from the conduct rules enshrined in the framework. Even if the FBC can withdraw the banking license in the last resort,46 this measure might not exert an effective pressure on the market participants’ behavior in this context since the market participants consider such an extreme sanction as unlikely happening as a consequence of a market abuse case.

- The Establishment of Presumptions

Under no circumstances does the Circular on Market Behavior state a regime of market abuse per se; rather the Circular enacts presumptions in lieu thereof. This means that certain conducts assumedly constitute cases of market abuse. The realization of an enshrined criterion implies a reversal of the burden of proof from the administrative authority to the suspected party. The latter has to refute the presumption to be exonerated from the charge of market abuse. Moreover, the presence of accepted market practices is deemed to help this party reverse the presumption of misbehavior. Therefore, the targeted conduct will be considered as abusive only if the signal of bad practice remains unrebuted.

- The Correct Conduct as a Duty to the Financial Markets as a Whole

Emphasis is put on the distinction between the banks’ duties towards their clients and the ones directed to the market as a whole. On the one hand,
Art. 11 of the Stock Exchange Act already disqualifies certain behavioral conducts of securities dealers related to their clients. On the other, the administrative guidelines are deemed to protect the financial markets in general.

Accordingly, the Circular on Market Behavior addresses the prosecution of market misconduct that harm the integrity of the financial sector as a whole. This way of proceeding highlights the responsibility of the financial services providers for fairness in the markets. Therefore, their duties surpass the contractual obligations that they owe to the trading parties.

3. The Prohibition of Various Forms of Market Abuse

3.1 The Information Abuse

Information abuse consists in the misuse of inside information. Insiders exploit a privilege that they have gained by virtue of their particular position as financial intermediaries. The accumulation of the two following elements leads to the prohibition enshrined in the Circular.

First, the object of the ban is associated with the inside information. In a market context, information can influence the transaction related decisions of those who have access to specific information. The definition of inside information contains two features, which are similar to those described in the EC Market Abuse Directive:

- **Publicly non available information**: The guidelines describe this notion in contrast to the notion of publicly available information. If information is properly disclosed, the privileged parties are allowed to trade on its basis. The notion of inside information is thus closely related to the disclosure requirements.

- **Price-sensitive information**: The concept of the Circular depends on the aptitude of the information for affecting the price level. The test is that if the information were made public, it would be likely to have a significant effect on the securities.

Second, the prohibition refers to the misuse of information gained by market actors. The concerned action consists in gaining an unfair advantage by utilizing inside information. For instance, it involves the sale of securities by a market player who knows, on the basis of inside information, that the price of those securities is about to fall, or the purchase of securities by a market player who knows that they are on the point of rising. Furthermore, it is clearly forbidden to pass inside information on to a third party.

In terms of involved persons, reference can be made to the European legislation. According to the EC rules, the notion of insider dealing encompasses all those persons who, by their business or professional relationship with the company, are likely to have access to privileged information; they are called primary insiders. Moreover, secondary insiders are also concerned by the market abuse regime. While not in an access relationship to the issuer, secondary insiders acquire the relevant information from an insider source. By contrast, the persons who have a disadvantage due to the fact that they do not possess the same basic information are considered as outsiders; they should not suffer a discrimination resulting from the special position of insiders in companies.

In the Swiss supervisory system, the definition of insider is less broad in the sense that secondary insiders will not always fall under the scope of the Circular on Market Behavior. Being not regulated, the journalists are, for instance, not covered by the administrative guidelines. In cases of media, the insider who passes on the information remains the only responsible for the breach. However, the secondary insiders who fall under the scope of the Circular are covered by the prohibition of information abuse; in fact, pursuant to its definition, inside information...
must not necessarily arise in the sphere of activity of the insider. For instance, if the inside information is provided by a specific activity of the company, employees from other sectors are not required to disclose the information; however, if they have access to the valuable information, they are considered as secondary insiders and have, therefore, to abstain from misusing inside information.

3.2 The Market Manipulation

As the market works best if no player can interfere with the proper operation of market forces and the interplay of supply and demand, it is at the core of competition law to prevent market manipulation from arising. In a European perspective, such fraudulent mechanism is even approached as an abuse of a dominant position.

In the EC Market Abuse Directive, market manipulation is embedding in its definition the transactions or orders which distort the market as well as the dissemination of information which gives false or misleading signals. Pursuant to the Circular on Market Behavior, the FBC adopts a narrower definition of market manipulation, concentrating on the completion of transactions; the use of manipulative information is prohibited under the third category of market abuse.

Under the EC Market Abuse Directive, market manipulation first implies transactions which give false or misleading signals or which set the price at an abnormal or artificial level. Prices typically rise throughout the manipulation period and fall post-manipulation; prices are apparently higher when manipulators sell than when they buy. Furthermore, transactions which employ fictitious devices or any other form of deception are also prohibited.

As the European legislation needs several notions to cover all the conceivable cases of market manipulation, the Swiss Circular puts emphasis on the requirement of an economic justification associated with the operation. Accordingly, market manipulation occurs if there is no legitimate reason for trading. This notion of economic justification is broad enough to encompass every relevant situation. From an economic point of view, the market participants engage in fictitious transactions; their intervention leads to a distortion of competition in financial markets.

These general notions need to be concretized. At the European level, an Implementing Directive targets two non-exhaustive lists of criteria which are taken into account to determine whether a market conduct is manipulative. The aforementioned Directive addresses itself primary to the Member States, which have to enforce the unified legislation. The Swiss guidelines also approach the problem with the help of a list of market misconduct. In fact, in order to give guidance on what is prohibited in the financial markets, the guidelines on market behavior provide a non-exhaustive list of signals of market manipulation. By doing this, the FBC clarifies its understanding of what are the practices to be considered as making no economic sense; in this regard, the target list is mainly intended for the market participants. Although no interdiction per se is created, stress is put on particular market conduct that may become problematic. For instance, wash sales are transactions in which there is no genuine change of ownership of financial instruments. This operation consists of selling and purchasing the same securities for the account of the same party within a short period of time without any economic justification (without, however, excluding the transaction-oriented daytrading); it is merely undertaken for the purpose of creating a false impression of market activity. Furthermore, improper matched orders consist of transactions to buy or sell the same quantity of a relevant asset at the same time by colluding parties; the involved parties

---

62 Circular on Market Behavior (n. 15), paragraphs 22–23.
66 Swan (n. 19), p. 46.

---

55 Art. 72 paragraph 1 of the SWX Listing Rules (n. 50).
58 Art. 1 paragraph 2 of the MAD (n. 13).
59 See Art. 1 paragraph 2 lit. a of the MAD (n. 13).
61 Art. 1 paragraph 2 lit. b of the MAD (n. 13).
intend to distort the price or liquidity of the targeted securities.

3.3 The Dissemination of False, Incomplete or Misleading Information

In the European legislation, the dissemination of false, incomplete or misleading information is comprised in the definition of market manipulation. The Swiss administrative regime, however, considers this offense as a separate form of market abuse. In this regard, the dissemination of various kinds of price-sensitive information is forbidden under the Circular; reference is specifically made to false, incomplete or misleading information. For instance, scalping involves purchasing financial instruments for one's own account before recommending them to others causing prices to rise and then selling at a profit. What is actually targeted is a discrepancy between what was communicated and the communicator's own perception. Like in the EC Market Abuse Directive, it is decisive whether the persons who spread the information knew or ought to have known that it was misleading. In fact, the importance is laid on the good faith of the persons who disclose the information. While spreading price-sensitive information, the concerned persons have to believe, in good faith, that their statement is true. Accordingly, prior to spreading any kind of rumor, they have to secure the truthfulness of their source.

3.4 The Principle of Good Faith

Eventually, the principle of good faith can be invoked for addressing other kinds of misconduct in the financial markets. Despite the fact that the absence of good faith is not considered as a separate category of fraudulent behavior, it enables the FBC to prosecute practices which do not fit in the three aforementioned forms of market abuse. Hence, it comprises the ability of the supervisory authority to develop its genuine practice continuously. This approach is a specific characteristic of the Swiss supervisory regime, finding no equivalent in the EC Market Abuse Directive.

In fact, this approach emphasizes the fair and correct behavior that is required in the financial markets. As an essential condition to be concerned by the prohibition, the practice has to damage the market as a whole. In other respects, the offense can merely constitute a breach of conduct rules under the terms of Art. 11 of the Stock Exchange Act. These rules result from the duty of the financial services providers to their clients. Overlapping these conduct rules is therefore not the purpose of the principle enshrined in the Circular.

Finally, this fourth aspect entails a certain amount of vagueness. The principle of good faith as anchored in the market abuse regime is helpful to tackle innovative market misconduct. In the rapidly evolving world of financial trading, it is not always possible for a regulator to anticipate in what forms the disruptive techniques may occur; consequently, some flexibility needs to be incorporated into the market abuse regime allowing its prohibitions to cover unforeseen situations. The principle of good faith appears therefore as an appropriate way to treat market misconduct which does not fit into one of the usual categories of market abuse. However, critics suggest that the market participants are, due to the created uncertainty, not able to deduce from the target principle what is expected and what is prohibited. In this sense, an excessive application of this criterion would endanger the important principle of legal certainty. Furthermore, it is worth indicating that criminal sanctions could not be built on such a vague criterion.

4. The Accepted Market Practices

The FBC mentions the inclusion of accepted market practices in its guidelines as conceivable defenses to the allegation of market abuse. This concern is currently referring to three forms of market abuse, namely information abuse, market manipulation

---

68 Swan (n. 19), p. 46; Besson (n. 5), p. 121.
69 Art. 1 paragraph 2 lit. c of the MAD (n. 13).
70 Swan (n. 19), p. 47.
72 Circular on Market Behavior (n. 15), paragraphs 36–38.
73 Treu und Glauben, principe de la bonne foi; it is worth mentioning that the principle of good faith is enshrined in Art. 2 of the Swiss Civil Code of December 10, 1907 as a general principle of the Swiss civil law.
74 It is worth indicating that the principle of good faith is considered as one specific aspect of the assurance of proper business conduct as required in Art. 10 paragraph 2 lit. d of the Stock Exchange Act (see for instance Besson [n. 5], p. 92).
75 Circular on Market Behavior (n. 15), paragraphs 39–40.
76 See Swan (n. 19), p. 27.
77 Circular on Market Behavior (n. 15), paragraph 2.
and the absence of good faith. Accordingly, some market conducts do not fall within the definition of market abuse even if they seem to fulfill the criteria described in the Circular at first glance.

Indeed a distinction needs to be made between two types of defenses to allegations of market abuse: The accepted market practices and the Safe Harbor Rules; the latter are more powerful defenses for the private actors. On the one hand, if ascertained, the defense resulting from the Safe Harbor Rules always implies the exoneration of the suspected person from the charge of market abuse. On the other, the subsumption of a market conduct under the accepted market practices only involves an indication that the conduct does not reach the area of market abuse due to the fact that its occurrence is expected in the financial markets, an Implementing Directive of the EC Market Abuse Directive establishes a list of factors which the Member States shall take into account when considering accepted behavior in the financial markets.

In fact, as the Swiss legislation knows no market abuse per se, the lists of accepted market practices solely highlight the possibility kept in the hand of the suspected party to refute the presumption of fraudulent behavior. If a conduct falls under an element described in the relevant list, it gives a signal which advocates the party's conduct. Accepted market practices are evidentiary defenses in the sense that the resulting indication helps the person suspected of market abuse to reject the charge of fraudulent behavior. Thus, the Circular gives some guidance as to which factors the supervisory authority will take into account in its decision whether a certain conduct does not constitute a case of market abuse. Indeed, the two lists are not exhaustive, which confirms that the mentioned factors are not the only ones likely to dismiss the charge of market abuse.

5. Selected Topics from the Organizational Obligations of Financial Services Providers

5.1 Introducing Organizational Measures in General

Organizational obligations are linked to the good corporate governance of firms. Obviously, private actors have to assume the responsibility for adopting an adequate organization. Insofar, directing and controlling the firm implies an awareness of their role in preventing fraud; therefore, they are basically free in choosing the measures which could eventually forestall market abuse.

Nevertheless, the supervisory authority imposes few elementary rules that the financial services providers shall follow. To determine organizational obligations aims at anticipating the risks posed by bad structures in companies. The regulatory issues concretize the duties of market participants implementing them; they are seen as minimum required for good practice.

5.2 Dealing with Conflicts of Interest

The presence of various kinds of interests leads to conflicting situations. "The duty of loyalty is a legal consequence of vesting the trustee with the interests of the beneficiary." Through organizational measures, the company ensures that the trustee acts in the interests of the beneficiary while potentially having contradictory interests.

In fact, the inflow of inside information needs to be organized and controlled in a way which allows that conflicts of interest are avoided or detected. In a preventive manner, the target company has to prevent conflicts of interest from arising. If not possible, dealing with these conflicts involves taking care

78 Circular on Market Behavior (n. 15), paragraphs 15–21, 30–35, 44.
79 See Art. 119 paragraph 2 lit. b of the FSMA (n. 12).
80 See Art. 1 paragraph 5 of the MAD (n. 13).
81 Directive 2004/72/EC implementing Directive 2003/6/EC as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers’ transactions and the notification of suspicious transactions (Implementing Directive), OJ 2004 L 162/70.
82 In regard to information abuse, Circular on Market Behavior (n. 15), paragraphs 15–21; in regard to market manipulation, Circular on Market Behavior (n. 15), paragraphs 30–35; in regard to the principle of good faith, Circular on Market Behavior (n. 15), paragraph 44.
83 See for the FSMA regime Swan (n. 19), p. 138.
84 Besson (n. 5), p. 90.
85 For further concerns, see Besson (n. 5), pp. 85–87.
86 Rashid Bahar/Luc Thévenaz, Conflicts of Interest: Corporate Governance and Financial Market, Leiden/Zürich 2007, p. 3.
87 Circular on Market Behavior (n. 15), paragraphs 45–47.
of the potential complications which could cause damage to market participants.

Insofar, corporate governance mechanisms protect the interests of all investors against corporate managers whose own interests do not necessarily coincide with those of the company’s stakeholders. The company ideally develops an adequate organization, provides for an appropriate formation of its staff as well as establishes an efficient control system.

Furthermore, the organizational measures are accompanied by the duty to disclose the conflicts of interest if they could adversely affect the customer, the financial actor being not able to prevent them from arising. This duty solely exists in cases in which the financial actor wants to act despite the presence of a conflict of interest; in other words, to abstain from engaging in the problematic transaction remains alternatively possible. Seeking to overcome the information asymmetry between the parties, disclosure has increasingly become the favored instrument of policy makers. Acting in a preventive way, this endeavor may decrease the risk that conflicts of interest harm the financial markets. Disclosure requirements concerning conflicts of interest are therefore complementary to the organizational obligations of the financial services providers.

5.3 Establishing Chinese Walls

It is very difficult to hinder market actors from utilizing privileged information considering the fact that inside information is very valuable for trading purposes. Actually, the prohibition sometimes implies that financial actors shall neither profit from favorable news nor avoid losses.

By contrast, it is easier to restrict the number of persons who acquire price-sensitive information with the help of Chinese Walls. To preclude information from spreading over the company seems the most appropriate solution to approach market abuse in a preventive manner. This approach is especially adapted to preclude secondary insiders from accessing to the problematic information.

Chinese Walls are intended to isolate inside information in the confidential area; this includes organizational measures, like spatial or personal detachment, as well as measures related to the internal organization or to the information technology.

5.4 Controlling the Employees’ Transactions

Monitoring the employees in order to detect and prevent market abuse is part of the financial intermediaries’ responsibility. According to the guidelines on market behavior, the single requirement associated with this obligation is formal; the concerned companies shall establish adequate measures in internal directives. Substantially, they enjoy the liberty of developing the organizational measures of their own choice.

For instance, the standard of behavior expected from employees is to be described by the internal directives. In doing so, the companies make transparent their expectations. In a preventive manner, the companies reduce the employees’ opportunities to commit market abuse. Monitoring them, the firms curtail the risks of infringement of the law. Consequently, the companies have to keep a close eye on the behavior of the staff to preclude their employees from damaging the sector.

Finally, only in this way the companies reach a position to discover the actual cases of market abuse. Due to their proximity, they are able to detect unusual activity as well as react in a proper manner. This approach involves not merely verifying that their employees’ behavior conforms to accepted market practices, but also acting against inappropriate conduct, thereby forestalling the reoccurrence of financial fraud. If not deterred, risks do indeed exist that the same type of misconduct recurs.

6. Summary of the Amendments to the Previously Intended Circular on Market Abuse

The core aspect of the new Circular on Market Behavior concentrates on cutting back the market abuse regime to the level of a principle based regulation. The FBC renounced several details of the pre-

---

89 Bahar/Thévenez (n. 86), p. 18.
90 Relating to the establishment of Chinese Walls in universal banks, see Rolf Watter, Chinese Walls bei Universalbanken?, SIZ 1991, p. 109; see also Art. 9 paragraph 1 of the Swiss Federal Ordinance of May 17, 1972 on Banks and Savings Banks (Banking Ordinance).
91 Circular on Market Behavior (n. 15), paragraphs 48–51.
92 Circular on Market Behavior (n. 15), paragraph 56.
viously proposed guidelines. Results from this work are brevity, clarity and simplicity of the Circular.

Nevertheless, the question remains as to whether enough liberty is left in the hand of the private sector. Although the FBC claims to have considered the criticism expressed by the financial sector, it has included, in fact, few amendments. It has focused on the form; the use of distinct terms and the shortening of the paper by half give a misleading impression of change. More particularly, the FBC seems to have abandoned the fourth category of market abuse. However, the absence of good faith may correspond to the previous category of other market misconduct. Except for the aforementioned points, modifications consisted in questions of detail. For instance, telephone records have to be stored during six months instead of two years. According to the financial sector, the initially prescribed requirement represented an excessive burden on the smallest companies.

In sum, due to the long practice and the works resulting from the elaboration of the administrative guidelines, the FBC has achieved to develop proper criteria to describe abusive conduct in the financial markets. In this sense, the Circular on Market Behavior adequately states which are the substantive conditions for establishing cases of market abuse.

III. Proposals for Improvement

1. The Need for Action to Enhance the Consistence of the Market Abuse Regime

As the substantial criteria which give rise to the charge of market abuse are included by the FBC in the aforementioned Circular, formal as well as procedural considerations should still be taken into account to complete the actual regulatory regime. This approach aims at increasing the impact of the material rules on the market players.

In October 2007, the Federal Department of Finance constituted an expert commission in charge of revising the system. The main objective of the designated body is to deal with criminal activity in the markets. By the end of 2008, the commission will have to submit a report about the possibilities to draft new legal provisions helping to combat market abuse.

Our paper does not attempt to give the only conceivable solutions. Nevertheless, it is deemed to provide ideas, to indicate eventual directions as well as to raise suggestions for improvement. The central aspects that deserve attention are threefold:

- **Anchoring Market Abuse Principles in a Financial Law**

As far as the regulatory efforts in Switzerland are concerned, the legitimate emplacement of the market abuse principles should be in a financial law.\(^94\) Though, prior to regulating more, the state needs first to carefully consider less restrictive alternatives.\(^95\) If the enshrinement in a financial law were to be positively evaluated, the most adequate law would be the Stock Exchange Act, due to the fact that it covers the regulated markets and that it concentrates on the protection of investors and market efficiency.\(^96\)

Substantially, the establishment of criteria in a legal framework is merely envisioned for market abuse principles. The targeted law should designate the various categories of market abuse as well as enact the key conditions for their occurrence. By contrast, organizational obligations should remain under the control of the FBC (or the FINMA, respectively), the self-regulatory bodies and the financial intermediaries themselves.

- **Revising the Criminal Justice System against Market Abuse**

Formally, the question can be asked whether the criminal provisions against market abuse should remain in the Swiss Criminal Code or should rather be transferred into a financial law like the Stock Exchange Act. Hitherto, the authorities for criminal prosecution have had the largest competence to address market misconduct. Concerns have indeed been raised about reducing the power of the criminal authorities in regard to market abuse prosecution. In our opinion, the most severe cases should remain (as ultima ratio) within the competences of the criminal law judges (and the legal framework of the Swiss Criminal Code), however, the legislator could give more

\(^93\) Circular on Market Behavior (n. 15), paragraph 64.

\(^94\) In this sense EBK-Sanktionsbericht (n. 22), p. 50.


\(^96\) The objective of the framework is defined in Art. 1 of the Stock Exchange Act.
importance to the administrative enforcement without setting the penal provisions completely aside.

- **Punishing Market Abuse with Direct Sanctions from the Supervisory Authority**

Specifically, the designed expert commission has to deal with the sanction system related to fraudulent behavior in general. So far, the FBC has had limited instruments at its disposal for reacting to market abuse. The FBC has had limited instruments at its disposal for reacting to market abuse. According to the possibilities of sanctions, there are either weak or rigorous consequences of the infringement of the law. The supervisory authority can merely reprimand the market actors or withdraw their authorization to trade; virtually no reasonable administrative sanctions exist for moderate infringements of the law.

To enhance the prosecution of market abuse, the key lies in entrusting the supervisory authority with effective disciplinary and enforcement powers to address market misconduct. The supervisory authority should receive more power in order to punish market offenses directly with pecuniary sanctions. The more constraining the administrative provisions against market abuse are established, the wider ranging legal consequences resulting from a breach of duties by the market players should be available. Such an approach would help the market abuse provisions exert a real influence on the behavior of the market participants. As a result, the market abuse regime still needs amendments. Nevertheless, as long as pecuniary measures are involved, avoiding disproportionate sanctions remains a concern; i.e. by no means should the Swiss authorities reproduce the excessiveness of the US Sarbanes-Oxley Act. Furthermore, criminal pecuniary measures are subject to the supervision by the European Court of Human Rights in respect of compliance with fundamental legal principles and human rights; insofar, it might be doubtful to what extent the FBC (or the FINMA, respectively) is to be considered as independent judiciary body (Art. 6 EHRC). This problem could be overcome by introducing civil law sanctions such as the restitution of illegally or illegitimately acquired profits in the sense of Art. 423 of the Swiss Code of Obligations (disgorgement of profits).

2. **The Promotion of Prompt Disclosure of Inside Information**

Companies listed on the Swiss Exchange are subject to continuing transparency obligations for the purpose of ensuring a fair and equal treatment of the shareholders. Disclosure appears as a powerful tool for influencing the behavior of companies and protects investors. Ad hoc publicity requirements are thus stated in Art. 72 of the SWX Listing Rules. What is requested from the issuers of financial instruments is public announcement of inside information through accepted channels.

In fact, to foresee mandatory disclosure reduces the potential for insider dealing. It is very difficult to preclude market actors from utilizing privileged information due to the fact that such behavior is very valuable for trading purposes. Requiring a prompt and accurate disclosure of inside information combats insider dealings in a preventive way. Public disclosure requirements and market abuse provisions complement each other and should therefore not be considered separately.

However, there is a limit to the disclosure requirements. In this respect, soliciting an absolute equality of information would undermine any incentive that a person would otherwise have to conduct research or collect information. Excessive disclosure requirements may even inhibit the markets' informational efficiency rather than incite private actors to seek for new information. Not only the benefits have to be taken into account while evaluating new disclosure rules, but also the potential drawbacks implied by the target requirement. Therefore, new disclosure re-

98 Expert Commission Zimmerli, Sanktionen in der Finanzmarktaufsicht, II. Teilbericht der vom Bundesrat eingesetzten Expertenkommission, August 2004, p. 17; see further EBK-Sanktionsbericht (n. 22), p. 17.
99 Swiss Code of Obligations of March 30, 1911 (CO).
101 See Organisation for economic co-operation and development (OECD), Methodology for assessing the implementation of the OECD Principles of Corporate Governance, Paris 2006, p. 50.
102 Ferrarini (n. 64), p. 730; Ruchet (n. 4), p. 495.
103 Weber (n. 4), p. 304; Rider/Alexander/Linklater (n. 9), p. 2.
104 Avgoulas (n. 1), p. 82.
quirements must be considered carefully with regard to their impact on the behavior of market actors.

3. The Duty to Report Suspicious Transactions

Concerning the detection of market abuse, solutions must be found to facilitate the investigations by the supervisory authority. On this note, some legal frameworks impose a duty to notify suspicious transactions of financial companies.\(^\text{105}\)

So far, the Swiss system has solely stated a duty to report transactions suspected to violate the legal provisions against money laundering. The target reports are first addressed to the Money Laundering Reporting Office.\(^\text{106}\) If necessary, this office forwards the reports to the law enforcement agencies. At the moment, this is the Anti-Money Laundering Control Authority.\(^\text{107}\) Together with the FBC, this authority will be integrated into the authority for financial market supervision, FINMA.\(^\text{108}\)

The fact that the supervision of the financial sector is to be merged with the integrated authority represents a good opportunity to create a similar system of notifications associated to market abuse offenses. In fact, it would be most efficient that any kind of suspicious criminal activity in the markets must be notified in a single report to an office which would then communicate the relevant cases to FINMA.

IV. Concluding Remarks

In its practice, the FBC has developed the relevant criteria to subsume a conduct under market abuse. After the rejection of the Circular on Market Abuse, the FBC brought a revised version into force which was renamed Circular on Market Behavior. In a nutshell, the intention of the supervisory authority essentially consists in formally codifying its previous practice.

First, the guidelines define the various categories of market abuse. Information abuse bans insiders from misusing the information that they possess due to their privileged position. Market manipulation implies that market prices are secured at a competitive level which reflects competitiveness in the markets. The dissemination of false, incomplete or misleading information is also prohibited. The principle of good faith can eventually also give incentives to market players for not conducting other kinds of misconduct.

Second, organizational measures aim at helping financial actors achieve a good corporate governance. The Circular on Market Behavior merely prescribes minimal requirements; the particularities remain in the hands of the private sector.

Undoubtedly, the administrative enforcement of market abuse needs to be enhanced. The central aspect concerns the creation of an efficient system to combat infringements of the law. The financial legislation should be revised to give to FINMA real powers for prosecuting market abuse (i.e. pecuniary measures, repayment of illegitimate profits). The expert commission constituted by the Department of Finance is entrusted with the task of seizing suggestions to amend the system. Therefore, significant improvements of the financial markets legislation can hopefully be expected in the future.

---

\(^{105}\) For instance, the British supervisory authority requires that suspicions of market abuse are reported (Financial Services Authority [FSA], The Full Handbook, paragraph SUP 15.10 of the Supervision Manual).

\(^{106}\) The Money Laundering Reporting Office Switzerland (MROS) functions at the Federal Office of Police (fedpol) as a relay and filtration point between financial intermediaries and the law enforcement agencies.

\(^{107}\) The Anti-Money Laundering Control Authority (AMLCA) supervises financial intermediaries solely to the extent of their compliance with the legal framework against money laundering.