CapLaw
SWISS CAPITAL MARKETS LAW

No. 4/2012

Securities

Regulatory

Takeover

News | Deals & Cases

Events

The JOBS Act: Implications for Non-US Issuers

Reference: CapLaw-2012-38

This article outlines key features of the recently-signed Jumpstart Our Business Startups Act (JOBS Act), which is intended to streamline access to the US capital markets for a range of issuers. Among other developments, the JOBS Act reduces disclosure burdens, eases requirements for initial public offerings for certain companies, relaxes restrictions on communications around securities offerings and increases minimum thresholds for mandatory SEC reporting.

By Dorothee Fischer-Appelt

1) Introduction

The Jumpstart Our Business Startups Act (JOBS Act) was signed into law by President Obama on 5 April 2012. Its intention is to increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies. The JOBS Act reduces some of the disclosure and regulatory burdens for initial public offerings (IPOs) by *emerging growth companies*. It also eases restrictions on communications with potential investors in US private placements and contains new rules for small company capital formation. In addition, the JOBS Act increases the thresholds that trigger registration for companies that are not currently reporting with the Securities and Exchange Commission (the SEC). The JOBS Act does not have a particular focus on *foreign private issuers* (FPIs), but non-US companies can make use of most of its provisions, and this article focuses on the JOBS Act's implications for those issuers.

2) Emerging Growth Company IPOs

Title I of the JOBS Act, *Reopening American Capital Markets to Emerging Growth Companies,* is intended to increase capital formation through IPOs. The report that preceded the JOBS Act highlighted that growth companies create more new jobs post-IPO than growth companies that are sold in an M&A transaction. In addition, following the Sarbanes-Oxley Act, the US had been criticized for being an overly burdensome jurisdiction for listed companies, and the JOBS Act is intended to restore the US markets' competitiveness for IPOs.

Emerging growth companies (EGCs) are not necessarily small issuers: They are companies with less than USD 1 billion of total annual gross revenues. That figure would have historically included a significant share of US IPOs. Excluded are companies that sold stock (but not debt) to the public in the US on or before 8 December 2011. An issuer that is a public company outside of the US but has not made a SEC-registered equity offering can still qualify as an EGC. EGC status is lost after a company has crossed certain thresholds (such as the last day of the first fiscal year in which the

company has at least USD 1 billion in total annual gross revenues), or, the latest, on the last day of the fiscal year ending after the fifth anniversary of the IPO.

One key benefit for a FPI is the exemption from obtaining the auditor attestation report on internal controls over financial reporting mandated under section 404 of the Sarbanes-Oxley Act, and which has been costly to prepare in practice. However, an EGC will still be subject to the requirement that management establish, maintain and assess internal control over financial reporting, and its CEO and CFO will still be required to provide Sarbanes-Oxley-compliant certifications. In addition, EGCs are only required to present two (rather than three) years' of audited financial statements in an IPO registration statement (including for the MD&A section as well as selected financial statements). It remains to be seen whether this will be taken up widely in practice, as it may be easier to market an IPO to investors where a longer track record is presented. In addition, the SEC has clarified that first-time adopters of International Financial Reporting Standards (IFRS), or otherwise required by International Accounting Standards to provide three statements of financial position, cannot benefit from this rule.

There are other disclosure liberalizations, such as the exemption from the *say-on-pay* rules under the Dodd-Frank Act and golden parachute provisions and detailed compensation disclosure requirements from which FPIs are already exempt.

Another benefit of EGC status is that companies are permitted to submit draft registration statements on a confidential basis, which was previously only available for FPIs and was limited by the SEC at the end of last year to FPIs that have a dual listing (and in certain other limited circumstances). If otherwise available, FPIs can elect the latter confidential submission process, provided they do not take advantage of any benefits available to EGCs. Alternatively, they can comply with the EGC rules and file confidentially under those. The new confidential filing process requires making a public filing 21 days prior to the road show, which includes the original submission and confidentially submitted amendments.

EGCs are also exempt from compliance with new or revised financial accounting or auditing standards until the date that such accounting standards become broadly applicable to private companies. It is possible to elect to adopt some but not all of the other disclosure liberalizations, but an affirmative choice has to be made for all new and revised accounting standards.

The new rules also include important liberalizations with respect to research reports and communications with investors. First, the JOBS Act amends Section 2 (a) (3) of the Securities Act of 1933 (Securities Act) by adding a provision to the effect that the publication or distribution by a broker-dealer of a research report about an EGC in connection with a public offer of its common equity securities does not constitute an *offer* of securities. This provision applies irrespective of whether an IPO registration state-

ment has been filed or is effective or whether the broker-dealer is participating in the offering. Distribution of research reports is not limited to qualified institutional buyers. Second, Section 15D of the Securities Exchange Act of 1934 (Exchange Act) is amended to the effect that neither the SEC nor any registered national securities association (in particular, the Financial Industry Regulatory Authority (FINRA)) may adopt or maintain any rule or regulation in connection with an IPO, restricting, based on functional role, which associated person of a broker-dealer may arrange for communications between a securities analyst and a potential investor or restricting the analyst from participating in any communications with the management of an EGC that are also attended by other associated persons of the broker-dealer.

These changes for research reports are significant, although it remains to be seen how they will impact current practices. The SEC recently issued further guidance on some of these changes. A certain reduction of the *black-out* period following completion of a distribution of an IPO is already noticeable, with many market participants reducing the customary 40-day blackout period to a voluntarily agreed-upon 25-day period.

However, a number of the large international banks are still subject to the global research analyst settlement, and the SEC recently confirmed that they must continue to comply with its provisions unless and until amended by court order or superseded by new rules.

In addition to the liberalization of research, the new rules also allow *test-the-waters* communications before, during or after the registration statement for the IPO of an EGC has been publicly filed. These communications are limited to communications with QIBs and institutional accredited investors, and are not subject to the otherwise applicable restrictions on pre-filing communications under the Securities Act or the requirements in relation to *free-writing prospectuses* that have to be filed with the SEC. Testing-the-waters can consist of both oral and written communications. Meetings have to be strictly limited to qualified investors as otherwise they could be deemed a road show. The formal solicitation of orders and book building would not occur during test-the-waters communications that take place pre-filing, as broker-dealers are required to make a preliminary prospectus available before soliciting customer orders.

Allowing test-the-waters communications constitutes a significant change and offers the possibility to engage in certain practices that have been widely used in non-US deals, where it has been common practice to hold investor meetings with sophisticated investors to gauge interest in a proposed offering *(pilot fishing).* However, test-the-waters communications are subject to US anti-fraud liability under Sections 17 and 10 (b) of the Securities Act and potential liability under Section 12 (a) (2). Therefore, as a practical matter, their use will be the subject of careful consideration, especially before a registration statement has been filed. In addition, model provisions for indemnities,

covenants and representations in underwriting agreements have been developed. Further, state securities laws have to be considered *(blue sky laws)* where the offering is not listed on an approved national securities exchange.

This change may also affect the practice in non-SEC registered offerings, such as exempt offers under Rule 144A under the Securities Act (the exemption for private resales of securities to qualified institutional buyers). In the context of Rule 144A offerings, market practice has generally limited pilot fishing meetings in the US based on liability concerns. Depending on how widely test-the-waters communications will be used in the context of SEC-registered IPOs, pilot fishing for global offerings conducted under Rule 144A into the US and applying the safe harbor for offshore offerings under Regulation S of the Securities Act may become more common.

It remains to be seen whether the JOBS Act will pave the way for more FPIs to list and conduct their IPO in the US. The liberalizations are significant and make it easier to list initially, but FPIs will make their decision on where to list based on a number of factors, including valuations, investor base and other factors. Where a multitude of factors speak in favor of a US listing, there will be less resistance to a US listing as a result of the relaxation of rules, but the perceived liability risks in connection with a US listing remain.

3) Publicity Changes

Title II of the JOBS Act contains a fundamental change in approach to publicity in the context of exempt offerings, by calling on the SEC to remove the prohibition of general solicitation and general advertising contained in Rule 144A and in Regulation D with respect to accredited investors, provided that (with respect to Regulation D) the issuer has taken *reasonable steps* to verify that purchasers of the securities are accredited investors, using such methods as determined by the SEC, and with respect to Rule 144A, that securities are sold only to persons that the seller and any person acting on its behalf *reasonably believe* is a qualified institutional buyer. These changes apply in the context of Rule 506 of Regulation D, which permits an issuer to sell securities in a private placement to an unlimited number of accredited investors, and Rule 144A, but not in other private placements. Both rules are widely used for capital raisings as they do not require any Securities Act registration. The changes entail a shift of focus from the regulation of offers to the regulation of sales of securities. The SEC proposed rules to implement these provisions on 29 August 2012.

The JOBS Act did not mention if the publicity changes would have an effect on the prohibition of *directed selling efforts* under Regulation S, the safe harbor that is typically used in connection with an offering outside of the US. In is proposed rules, the SEC confirmed that what constitutes directed selling efforts will continue to be interpreted in a manner consistent with the definition of general solicitation and general

advertising in the context of a global offering relying on both Rule 144A and Regulation S. However, in the case of an offering conducted only outside the United States in reliance on Regulation S, the prohibition on publicity (including through unrestricted websites) in the United States constituting directed selling efforts remains.

As a result, there will likely be a number of practical implications for publicity guidelines used in global offerings combining Rule 144A and Regulation S offerings once the SEC's rules will be adopted, including fewer restrictions on the destination of offering materials and website filters to prevent US access. At the same time, it is important to note that anti-fraud liability still applies to these offerings and associated offering materials. Widespread marketing through Internet, TV and ads in the US is unlikely to be popular. In addition, in the context of Rule 144A offerings, restrictions on publicity under state securities laws also have to be considered.

4) Small Company Capital Formation

Title IV directs the SEC to adopt more detailed rules for public offerings of equity, debt securities and convertible or exchangeable securities that do not exceed USD 50 million in the aggregate in any 12-month period beyond exemptions currently unavailable to FPIs (other than Canadian issuers). When adopted by the SEC, the new rules may offer an interesting alternative for capital raisings by smaller companies and could serve as a stepping stone to an IPO.

5) Exchange Act Registration Exemption

Titles V and VI of the JOBS Act increase the thresholds for registration with the SEC under the Exchange Act, which can require companies to register even where they have not conducted a public offering as a result of the number of their US securityholders. The minimum requirement was increased from 500 holders of record and USD 1 million of assets to 2,000 holders of record (or 500 holders who are not accredited investors) and USD 10 million of assets, effective immediately (with certain modifications for banks and bank holding companies). FPIs that are listed companies in their home jurisdictions typically avoid being caught by the Exchange Act registration requirements by taking advantage of an exemption provided in Rule 12g 3–2 (b) under the Exchange Act, which was modernized some years ago. However, this exemption is not available for non-listed companies such as many private equity, hedge and venture capital funds that may be able to broaden their US investor base and raise more funds in the US as a result of the increased Exchange Act thresholds, in particular to the extent the SEC will make conforming amendments to Rule 12g 3–2 (a) (which exempts FPIs with fewer than 300 holders resident in the US from Exchange Act registration).

6) Crowdfunding

The JOBS Act also contains a new exemption that permits raising funds over the internet from large groups of people by pooling small amounts of capital *(crowdfunding)*. However, crowdfunding is not available to FPIs.

7) Conclusion

The JOBS Act contains the most significant changes to US securities laws in several years. The changes to the communications rules for private offerings once adopted will undoubtedly affect market practice for both US and global offerings. In addition, the introduction of the new EGC category is significant and may make it more attractive for certain non-US issuers to conduct an IPO in the US. The market practice that will evolve over the course of the next few years in the context of EGC IPOs will also likely have an impact on Rule 144A practice in many important areas such as publication of research, test-the-waters communications and disclosure of financial information in the prospectus.

Dorothee Fischer-Appelt (dfischerappelt@sidley.com)

Tailor-Made Bond Financing Opportunities: Tapping the German High Yield Retail Market– The "Schaeffler" Precedent

Reference: CapLaw-2012-39

In times of aggravated credit financing and continuing volatility in the markets, issuing high-yield corporate debt to retail investors can prove a feasible way of accessing money–for small, medium and even large enterprises. Historically, the purchase of individual bonds was beyond the reach of most private investors because the minimum amount needed to trade was typically € 50,000 (equivalent) or even € 100,000 (equivalent), but the retail bond market now provides direct access to corporate bonds for trading in retail-friendly increments of around € 1,000 (equivalent). Making corporate bonds available for lower amounts is a response to strong private investor demand. For instance, Schaeffler Group's[1] € 300 million 6.75% senior secured notes offering in denominations of € 1,000 to retail investors and an additional approximately € 26 million 6.75% senior secured notes offering to Schaeffler employees in Germany, which both completed in July 2012, serve as a paradigm for a high yield bond offering issued to retail investors. The transaction has showcased an innovative structure that combines an offering to retail investors in Germany and Luxembourg with a separate

1 Schaeffler Group is a leading manufacturer of rolling bearings and linear products as well as a renowned supplier to the automotive industry of high-precision products and systems for engines, transmissions and chassis applications.

employee offering, thereby also resolving concerns that generally arise in the context of retail offerings. As the first single B rated credit high yield bond offering directed at retail investors, the deal is truly a market first.

By Gernot Wagner / Susanne Lenz

1) Introduction

When access to traditional bank loans is progressively becoming difficult, even for seasoned issuers with good credit ratings, tapping the capital markets becomes a viable alternative in light of accretive financing needs. High-yield bond offerings, though still mostly centred in the United States, are proving more and more popular in Europe. In Germany, high yield bonds have not only been issued to institutional investors but over the last years increasingly to retail investors as well. Some of the local exchanges have put up retail bond platforms on which issuers can sell their bonds to retail investors without the costs involved in having an investment bank underwrite the issue. The Frankfurt Stock Exchange, for instance, fairly recently launched a retail-segment for bonds *(Entry Standard),* thereby providing a platform to sell bonds to retail investors. Similar platforms exist at other German stock exchanges. Admission to bond trading in the Entry Standard, for instance, is fast and easy: The application for inclusion in exchange trading has to be filed by a registered trading member of the Frankfurt Stock Exchange, who will also monitor compliance with transparency requirements and act as central interface between company and exchange. Before the issue is launched, the company has to submit and publish an approved securities prospectus, a concise company profile with information on the securities to be issued, a corporate calendar, audited annual financial statements, certain financial ratios, proof of creditworthiness by an approved rating agency as well as various corporate documents. An appointed and assigned *Deutsche Börse* listing partner will assist the company in structuring the issue in terms of scale of emission, maturity and interest rate calculation. There are no formal requirements regarding the securities other than a maximum denomination set at € 1,000 and the prerequisite that the debt must not be subordinated. After the issue date, companies are obliged to submit annual and half-yearly financial statements, annual follow-up ratings and certain balance sheet ratios. In addition, issuers are required to disclose sensitive information that could influence the bond price.

Besides the fact that the German retail market is largely untapped, advantages of trading bonds on retail market platforms from the issuer's perspective are obvious: The lack of formal requirements and less stringent follow-up obligations, the fact that the issue does not need to be underwritten by an investment bank, established trading platforms and widespread prevalence of online transactions, retail-friendly standardizing, low transaction costs, subscription at issue price and transparent secondary market trading.

From an investor's perspective, advantages are equally obvious: Bonds offer higher returns than cash to compensate for interest rate and credit risk. The money can be moved in and out of the corporate bonds without any penalty payments. Whenever the investor wishes to cash in the bond he will receive the market price.

Nevertheless the advantages do come at a cost. The greatest concern raised by high-yield bond retail issuances is the lack of protection of retail investors who carry the credit risk. No strict tests are applied to the issuer and only few key financial figures are published. Credit ratings can be obtained from small regional rating agencies. Documentation is kept to minimum without extensive covenant-protection. Retail investors may not even appreciate the risks involved in speculative-grade investment. Investors need to be careful to perform due diligence on the business in which they are contemplating investing, including examining the issuer's market share, its relationship with customers and suppliers, its brand image, the prospective use of bond proceeds, the stability of cashflows and the service of debt.

In addition, secondary market prices of corporate bonds swing significantly and it might prove difficult to find relevant trading information. Trading prices of bonds fluctuate according to the balance of supply and demand and bond prices tend to drop when interest rates rise. Obviously, this will not come into play if the investor holds the bond to maturity.

2) The Schaeffler Precedent

a) The High Yield Retail Offering

In February 2012, Schaeffler AG already issued € 2.0 billion high yield senior secured notes in four tranches with a mix of currencies and maturities, a benchmark offering. The precedent-setting deal included a *pari passu* structure with a unique dollar-for-dollar voting mechanism. The bond was issued in minimum denominations of € 100,000 to institutional investors.

The latest bond, which completed in July 2012, however, was issued in minimum denominations of € 1,000. Contrary to market practice, it contained an extensive covenant package, *i.e.* included the same covenants as the February 2012 bond, thereby resolving all doubts about the lack of protection of retail investors.

Over the last three years, more than two billion Euros have been placed directly with investors. These retail bond offerings mostly had smaller deal volumes compared to the Schaeffler deal volume, between € 50–100 million and generally did not include any covenants. Yet, unsecured bond offerings are risky investments from the investor's perspective and institutional investors are not necessarily keen to participate in such deals. In contrast, the covenant package on Schaeffler's second high yield offering included a full security and collateral package and was picked up by retail investors

as well as institutional investors. The transaction might signal the start of a new trend whereby high yield issuers that have traditionally only tapped the institutional market, could now move away from the € 100,000 denomination and instead choose to go down the path of having the prospectus approved by a regulator in order to tap the high yield retail demand.

b) The Employee Offering

In addition to what has been set forth above, the game-changing deal also provides a blue-print for an employee offering for European Companies with a similarly large employee base. Schaeffler employs approximately 29,000 individuals in Germany. These individuals were given the opportunity to subscribe for the bonds (up to € 50 million) once the retail tranche had priced. Had it been structured differently, the employees would not have known the coupon prior to subscribing the bonds and, therefore, would have had the same risk as other institutional and retail investors. The combined transaction—the entire transaction was treated as a single offering—was structured as a € 200 million offering, with up to an additional increase of € 300 million and a further increase of up to € 50 million for the employee offering. After a two-day offering period for the retail tranche, the deal priced at 6.75%. Employees could then subscribe the bonds from July 6, 2012 until July 13, 2012 at the same price, *i.e.* the employees were given a week to set up securities accounts, receive sufficient education from the company on the investment and subscribe for the bonds.

c) Regulatory Issues

The transaction demonstrates to the market that it is possible to obtain regulatory approval of a complex offering of this kind. This is despite the fact that the Luxembourg regulator (the *Commission de Surveillance du Secteur Financier,* or the CSSF) does not have extensive experience with traditional high yield bonds. Generally high yield bonds are not offered to retail investors and hence do not require approval by European regulators. The approval process therefore took significantly longer than expected and should improve in future deals with a similar structure.

The Schaeffler deal had 28 guarantors. The Prospectus Directive requires companies to publish the financials of the guarantors as well as any risk factors specific to each guarantor which would have added hundred of pages to what was already a 496-page-document. A waiver was obtained to use the consolidated accounts instead of individual financial statements of each guarantor.

3) Conclusion

Given the continuing volatility in the markets, Schaeffler AG's high yield bond offering to retail investors and employees can be considered a blue-print for other issuers to tap not only the institutional markets, but also have access to retail money. With sav-

ings rates at a record low and nervousness about the stock market, individuals with as little as € 1,000 will be able to access the corporate bond market. Other fixed income assets look by far less attractive. Though financial markets remain stressed, high yield corporate bonds have proven surprisingly resilient with default rates well below the historical average.

Gernot Wagner (gernot.wagner@allenovery.com)
Susanne Lenz (susanne.lenz@allenovery.com)

Client Asset Segregation—Much Ado About Nothing or the End of the World as We Know It?

Reference: CapLaw-2012-40

When assessing the turbulence on the financial markets of the last few years, one of the main outcomes for investors was a heightened awareness of cash and security arrangements. In particular, it has become *en vogue* among asset owners to ask their custodians to segregate client assets from the custodians' proprietary assets. While asset segregation has thus become a global topic, the legal effects of such segregation may differ from jurisdiction to jurisdiction. This article provides a summary overview of the patterns of asset segregation and their (possible) effects under Swiss law.

By Renato Costantini

1) Introduction

It is fair to say that the function of custody in the world of securities has, hitherto, been seen as rather dull. There was a perception that custody was a commodity and was viewed as the poor relation compared to other services purchased by investors. Today, we are seeing a *much greater interest in and awareness of cash and asset safety.* After all, the smartest allocation decisions and the appointment of the finest investment managers may all be in vain if the ownership of cash and securities is ever called into question.

As a result, among other measures, such as contractual limits on set-off and rehypothecation, strengthened liability for (sub)-custodians, and the introduction of OTC clearing regimes, investors are increasingly demanding for segregation of their cash and securities deposits. But what does that exactly mean and what are the *legal effects of asset segregation?* Is it possible to assess this on a general basis or can it only be based on knowledge and experience of the particular circumstances? In order to answer these questions, in particular the one on the legal effects of asset segregation, it is important to first understand the patterns and motives of asset segregation.

2) The Omnibus Account Structure—The World as We Know It

Normally, investors appoint a custodian bank to safeguard their securities and to hold their cash balances. The custodian banks, in turn, have securities and cash accounts with other custodians or with the Central Securities Depository (CSD), where securities are ultimately held. For cross-border securities holdings, the *chain typically involves multiple custodians.* In fact, in many non-domestic markets, custodians engage local sub-custodians, who, in turn, have accounts with the domestic CSD.

To maximize the efficiencies of the multi-tiered structure, most financial intermediaries, including CSDs, have adopted the practice of holding securities in fungible pools in their own name with their upper intermediary, CSD or issuer (as the case may be). Accordingly, in such *omnibus account structure* the ultimate investor's ownership interest is not visible on the books of the issuer, the CSD or the other intermediaries, except, of course, for the custodian of the ultimate investor.

While the trend towards asset segregation in the aftermath of the financial crisis has apparently led to a general questioning of the omnibus account structure, it would be far too simplistic to just adopt such set-up universally. Rather does appropriate and efficient asset protection require an *in-depth analysis of the asset holding structures at stake,* in particular in light of all relevant jurisdictions involved. When deciding on asset segregation, one must first of all be aware that the sole fact that securities are normally held in the name of the intermediaries, and not in the name of the ultimate investor (omnibus account structure), *does not allow any definite conclusion as to the entitlement* of the investor to the securities held through such structure. In fact, to put it simplistic, two different ownership models have to be distinguished in modern securities holding:

In Model 1, the holding of the securities through and in the name of intermediaries does not alter the contractual or corporate relationship between the ultimate investors and the issuers of the securities. Absent agreement to the contrary, *investors are* the creditors and the shareholders of the issuers and, thus, *the legal owners of the securities.* Model 1 is normally adopted in most civil-law jurisdictions, such as Switzerland. In contrast, *in Model 2,* the holding of securities through and in the name of intermediaries leads to a transfer of title in the securities to the respective intermediaries. Accordingly, the *investor does not have any direct legal relationship with the issuer.* Rather does the investor (and any upper intermediary, except for the ultimate intermediary facing the issuer) have a mere claim against its upper intermediary. Model 2 is, in some instances, adopted in certain common-law jurisdictions, such as the UK and the US.

Further, and importantly, any *cash balances,* do, as a rule, only confer entitlements against the respective intermediary (but no upper-tier claims whatsoever). This basically applies to both, *Model 1 and Model 2.*

3) Motives and Effects of Asset Segregation

Given the different ownership models for intermediated securities holding, it is apparent that the motives and effects of asset segregation may differ from jurisdiction to jurisdiction:

a) Proof of Claim

In Model 1 jurisdictions, the segregation of client assets from the custodian's proprietary assets does normally have no direct influence on the entitlement to the assets booked on a specific account. This, because, here, a person in whose name assets are held in custody is not automatically regarded as being their legal owner. This would only be the case if the person depositing the assets in its own name is also the legal owner of such assets and, therefore, not only acts in its own name, but also on its own behalf. If, by contrast, the person holding the asset in its own name acts on another person's behalf, it does normally not have any ownership interest over the respective holdings. This typically applies to intermediaries who hold assets on behalf of their clients. Or, to put it the other way round, in Model 1 jurisdictions, the entitlement to assets in a securities account is not primarily determined by the name on that account. Consequently, *asset segregation* (or the change of the account name in favour of the client) does *basically have no direct influence on the entitlements to the assets* booked in that specific account.

This does, however, not mean that asset segregation is of no use whatsoever in Model 1 jurisdictions: Any co-mingling of client assets in omnibus accounts may complicate proprietary claims. Co-mingling and difficulties with proving ownership in an insolvency are exacerbated when assets are held through chains of intermediaries. In fact, for successful recovery of assets from the financial institution holding the assets, will require full proof of ownership. As custodians often use sub-custodians, which themselves may pool assets with those of persons who are unconnected to the client or its custodian, it may prove essential for the client in order to establish its ownership that assets where duly designated and segregated from third-party assets. Therefore, though not legally effective in the first instance, asset segregation may at least *help to properly prove ownership interests* in Model 1 jurisdictions.

Further, and in this context, asset segregation may, but need not, help to *accelerate the recovery process* in a custodian's insolvency. Liquidators may take time to return assets in the possession of an insolvent intermediary. This is particularly true for assets held as security, given that liquidators will want to be sure that the security cannot be applied before making a distribution. However, and contrary to what is sometimes suggested, asset segregation is no guarantee for an accelerated recovery in insolvency.

b) Establishment of Claim

In Model 2 jurisdictions, the segregation of client assets from the custodian's proprietary assets may, in fact, have a direct influence on the entitlements to the assets booked on a specific account. This, because such jurisdictions depart from the principle that the person in whose name the assets are held is to be regarded as their legal owner, regardless of whether that person acts on its own behalf or not. For instance, the fact that the assets of the custodian's client are duly segregated and categorized appropriately in the books and records of the custodian may lead to the establishment of a client asset trust. Consequently, if the custodian becomes insolvent, its clients will have a proprietary claim over the trust assets. Where this is the case, the clients are entitled to full recovery of the relevant assets. This applies to both, cash and securities. In fact, in case of a client trust, the clients will also have a proprietary right over any cash amount received by the financial institution from a bank at which the financial institution held an account containing client money. In contrast, if the relevant assets are not properly segregated and therefore not subject to a trust, the client is an unsecured creditor and would be entitled only to a share of any assets of the insolvent financial institution after all secured creditors and the costs of the insolvency have been paid for. This example illustrates that, in Model 2 jurisdictions, where title to assets held with intermediaries normally vests in the intermediaries (and not in the client), *the segregation of assets* (cash and securities) *may well have a direct legal effect, e.g.* the creation of a proprietary interest in client trust assets.

c) Regulation

Regardless of whether asset segregation has a direct effect on ownership under civil law (Model 2 jurisdiction) or not (Model 1 jurisdiction), the obligation to segregate client assets may also be driven by regulation. This out of two, basically different, rationales: First, for *asset protection purposes* and, second, for *reporting purposes.* While in the first instance the motives of the regulator are closely linked to civil law asset protection, the regulation in the latter case is driven by reporting duties of any kind, such as tax and qualified shareholder reporting. Over the last years, both types of regulation have increased and, thus, on their part, also contributed to the lifting of the omnibus-account-veil.

In some instances, *regulation does not impose* asset segregation, *but triggers certain obligations,* such as increased capital charges, if not put in place. For instance, under the current Basel III framework, lower capital charges apply for direct participants in central clearing systems only if client portfolios are fully segregated from the portfolios of the client's clearing member (segregation) and duly portable to another clearing member in the event of the default of the client's clearing member (portability). Further to such scenarios, where regulatory obligations are triggered by the fact that asset segregation is *not* put in place, it is also possible that regulatory obligations are trig-

gered by asset segregation which was implemented on a voluntary basis. Accordingly, also a segregation done on a voluntary basis should be thoroughly assessed prior to implementation.

4) Client Asset Segregation under Swiss Law

As Model 1 jurisdiction, Swiss civil law does not alter the ownership interest in securities just because they are held through and in the name of intermediaries. In fact, absent agreement to the contrary, such as fiduciary arrangements, a custodian holding client securities with a sub-custodian is not regarded as being the legal owner of its holdings. This irrespective of whether the custodian is holding the securities in its own name (omnibus account) or not. In order to have a valid ownership interest over securities held in (sub)-custody, it is therefore not necessary to book such securities in the client's name. Accordingly, under Swiss civil law, asset segregation does basically have no direct influence on the ownership interest in the securities held in a securities account (establishment of claim). As a consequence of this, the protection of assets in case of insolvency of an intermediary is granted irrespective of whether asset segregation is put in place or not. This does, of course, not exclude that asset segregation may be of use when proving proprietary interests in securities held with intermediaries (proof of claim).

Further and in line with general legal principles applicable in most Model 1 and Model 2 jurisdictions, cash balances qualify as mere claim against the respective intermediary under Swiss civil law. This is mandatory and cannot be amended by agreement. Accordingly and in contrast to some other jurisdictions, where cash balances can be segregated from the custodian's estate (client money), the segregation of cash balances would not lead to an ownership interest in such balances under Swiss civil law. In other words, like for non-cash assets, such as securities, client asset segregation does not have a direct influence on ownership interests: In case of cash, segregation has no direct impact because it would not lead to the establishment of a valid ownership interest over a cash balance, while, in case of securities, segregation has no direct impact because it is not required to establish a valid ownership interest over a securities account.

In accordance with Swiss civil law, Swiss regulation does not impose asset segregation of whatsoever kind. However, as in other jurisdictions, regulatory provisions may indirectly lead to asset segregation. For instance, under the Too Big to Fail legislation (TBTF) which became effective in March 2012, systemically important financial institutions are expected to prepare their organizational and operational set-up in order to assure that their specific recovery and resolution plan can be executed rapidly and effectively. While not explicitly required, asset segregation may well be part of such a plan in order to facilitate the portability of the respective assets to another financial institution.

5) Conclusion

When assessing asset protection arrangements, investors should be aware that, despite a general trend away from the traditional co-mingled omnibus accounts, asset segregation is not an obvious call. Rather, it is a *complex decision that requires rests on multiple factors,* such as laws and regulations (as applicable along the whole custody-chain), asset classes involved (cash *vs.* securities), quality of segregation ("on behalf of all clients" *vs.* "on behalf of *the* client") and level of segregation ("with custodian" *vs.* "with upper-tier intermediaries"). In this context, it is particularly worth noting that not all jurisdictions confer additional rights when asset segregation is implemented and that, wherever put in place, asset segregation will inevitably have an impact on the model of operating global custody and, thus, likely have costs and subsequent pricing implications. Today, it is therefore yet unclear whether asset segregation will effectively be established as an SOP all over the holding systems or whether it will be limited to specific patterns and situations. The fact that global custodians appear willing to invest in these changes and that clients appear willing to pay an increased price for custody services is, however, evidence of how recent events have changed, perhaps forever, our view of modern asset holding.

Renato Costantini (renato.costantini@doz.unilu.ch)

Swiss Takeover Board Proposes New Rules on Offer Consideration in Qualified Voluntary Exchange Offers

Reference: CapLaw-2012-41

On 4 May 2012, the Swiss Takeover Board has proposed a new set of rules governing the obligation of the bidder to offer an all cash alternative in qualified voluntary exchange offers. The most significant change pertains to the extension of the already restrictive rules to the twelve-month period prior to the announcement of the exchange offer. It is uncertain when and to what extent the proposed rules will become effective.

By Dieter Dubs / Mariel Hoch

Based on the experience gained since the rules regarding the obligation of the bidder to offer a cash alternative in certain situations of exchange offers have first been enacted in early 2009 (article 43 (2) FINMA Stock Exchange Ordinance (SESTO-FINMA)) and the Swiss Takeover Board's (TOB) Circular No. 4, the TOB has acknowledged that, in some respects, said rules are too burdensome on the bidders. On 4 May 2012, the TOB has proposed a new set of rules governing the consideration to be offered in voluntary exchange offers which include shares whose acquisition would entail a mandatory offer obligation (so called qualified voluntary offers; see proposed article 9a (1) of the Takeovers Ordinance (TOO)). The obligation to provide for a cash alterna-

tive in all situations of mandatory exchange offers remains unchanged (article 43 (2) SESTO-FINMA).

The new rules on qualified voluntary exchange offers shall be included in article 9a TOO and related provisions and shall replace the current Circular No. 4 in its entirety. The TOB had invited interested parties to comment on the new set of rules until 28 May 2012. When and to what extent the proposed new rules will become effective has not been communicated by the TOB. We expect the TOB's respective publication within the next few months.

The TOB proposes to differentiate the new rules in relation to the following three time periods:

– the twelve months preceding the announcement of the qualified voluntary exchange offer (pre-announcement or publication of the offer prospectus);

– from the announcement until the completion of the qualified voluntary exchange offer (the period should in our view end with the expiration of the additional acceptance period in order to avoid an overlap with the third period); and

– from the end of the additional acceptance period until the expiration of the best price rule (*i.e.* six months following the end of the additional acceptance period).

Under the current regime, the first period is free of any triggers for an obligation to provide a cash alternative in qualified voluntary exchange offers. Under the proposed new rules, however, the bidder shall be obliged to offer an all cash alternative to all recipients of the offer if the bidder has purchased 10% or more target shares for cash during the twelve-month period preceding the announcement of the qualified voluntary exchange offer (proposed article 9a (2) TOO).

In relation to the second period (*i.e.* from the announcement until the completion of the qualified voluntary exchange offer), no changes are proposed by the TOB under the new rules. Therefore, if the bidder (or any person acting in concert with the bidder such as the target company in case of a friendly offer) purchases any target shares for cash during this period, the bidder must extend an all cash alternative to all recipients of the qualified voluntary exchange offer (proposed article 9a (3) TOO).

It is only with respect to the third period (*i.e.* from the expiration of the additional acceptance period until the expiration of the best price rule six months thereafter) that the TOB has relaxed the current regime to some extent. The applicability has been limited to target companies, the shares of which are deemed illiquid according to the TOB's Circular No. 2. The bidder (or any person acting in concert with the bidder) is not

allowed to purchase any target shares for cash during said period if the target company's shares are deemed illiquid (proposed article 9a (4) TOO).

Given that the proposed rules do not contain anything to the contrary, we assume that it will remain permitted that the cash alternative corresponds to the minimum price whilst the shares offered in exchange contain a premium on the minimum price (see Circular No. 4). This important principle should, in our view, be expressly stated in the new set of rules.

The rules requesting cash alternatives for exchange offers are unnecessarily restrictive on the bidder (the new rules even more so than the existing ones). They increase the transaction costs for the bidder significantly and inhibit a number of exchange offers from being made at all. The TOB justifies the rules with arguments of equal treatment of the recipients of the offer and implies that cash is better than shares (the Merger Act implies the contrary). Shareholders may, however, always sell their target shares on the stock exchange if they wish to divest and do not wish to hold the securities offered to them for exchange under the offer. A bidder who may not or is not prepared to offer an all cash alternative must abandon his plan to submit an exchange offer. As a consequence, the potential recipients of such exchange offers are deprived from their choice to accept or decline the offer, which such potential bidder would otherwise have been prepared to launch.

Dieter Dubs (dieter.dubs@baerkarrer.ch)
Mariel Hoch (mariel.hoch@baerkarrer.ch)

FINMA Opens Consultation on Collective Investment Schemes Bankruptcy Ordinance

Reference: CapLaw-2012-42

On 10 July 2012, the Swiss Financial Market Supervisory Authority FINMA opened the consultation process on the Collective Investment Schemes Bankruptcy Ordinance (CISBO-FINMA). Since 1 September 2011 FINMA has been in charge for the bankruptcy over certain institutions subject to the Swiss Collective Investment Schemes Act (CISA), such as fund management companies, investment companies with variable capital (SICAVs), limited partnerships for collective investments and investment companies with fixed capital (SICAFs). As the CISA provides only a rudimentary framework for bankruptcy proceedings and confers FINMA the competence to issue implementing rules, FINMA has made use of this competence by drafting the CISBO-FINMA. The consultation on the CISBO-FINMA ended on 22 August 2012.

The present draft of the CISBO-FINMA provides for certain implementing rules that will equally apply to all types of institutions mentioned under the preceding paragraph as well as some institute-specific rules. For SICAVs, for example, the interaction between the various sub-funds requires institute-specific regulation, whereas in case of a bankruptcy over a fund management company, the segregation of the investment fund assets is subject to specific regulation. Compared with the Swiss Banking Act, which allows FINMA to issue implementing provisions for both, bankruptcies and restructurings, the CISA and consequently the CISBO-FINMA are restricted to bankruptcy rules only. The content and entry into force of the CISBO-FINMA shall to be aligned with the current revision of the CISA.

Sunrise Communications International S.A. Issues CHF 896,000,000 (Equivalent) Notes Due 2017

Reference: CapLaw-2012-43

On 19 July 2012, Sunrise Communications SA (Sunrise), a leading Swiss telecommunication operator, partially refinanced its debt by Sunrise Communications International S.A. (Sunrise International) successfully placing a CHF 896,000,000 (equivalent) aggregate principal amount of fixed rate and floating rate senior secured notes due 2017 in the market, and Sunrise itself raised a new CHF 250,000,000 revolving credit facility.

Both financings are guaranteed and secured by certain Sunrise group entities.

Credit Suisse Group (Guernsey) V Limited Issues CHF 3,800,000,000 of 4% Subordinated Mandatory and Contingent Convertible Securities

Reference: CapLaw-2012-44

Credit Suisse Group (Guernsey) V Limited (CS Guernsey) issued CHF 3,800,000,000 of Swiss law governed 4% subordinated Mandatory and Contingent Convertible Securities (MACCS) mandatorily convertible into 233,500,000 shares of Credit Suisse Group on 29 March 2013 (if not early converted upon the occurrence of certain contingency and viability events specified in the terms of the MACCS). The MACCS issuance is part of the set of targeted capital measures announced on 18 July 2012 that are expected to strengthen Credit Suisse's capital by CHF 15,300,000,000 in preparation for the Basel III regulatory framework.

To ensure the placement of the MACCS, the issuance was fully underwritten by strategic and institutional investors. MACCS in the amount of CHF 1,900,000,000 convertible into 117,000,000 shares (Tranche A) were directly purchased by the strategic and institutional investors (private placement). In order to allow existing shareholders to participate in the issuance, MACCS with an aggregate principal amount of CHF 1,900,000,000 convertible into 116,500,000 shares (Tranche B), were offered to existing shareholders of Credit Suisse Group AG by way of a public offering of preferential subscription rights (Rights). The Rights were exercisable from 20 July 2012 until 27 July 2012, noon (CET).

Of the MACCS offered in Tranche B, CHF 1,833,000,000 were subscribed by shareholders and investors exercising Rights (96.6% take-up). MACCS in the amount of CHF 64,000,000, for which Rights were not exercised during the subscription period, were sold to strategic and institutional investors per the definitive agreements of 18 July 2012, thereby ensuring the full placement of the CHF 3,800,000,000 of MACCS.

UBS AG Issues USD 2,000,000,000 7.625% Tier 2 Subordinated Notes Due 2022

Reference: CapLaw-2012-45

On 17 August 2012, UBS AG, acting through its Stamford Branch issued USD 2,000,000,000 7.625% Tier 2 Subordinated Notes with a maturity of 10 years (Notes). The Notes constitute a loss-absorbing instrument, providing for a full write-down, if UBS AG's CET 1 capital falls below 5% of its risk-weighted assets, and qualify both as tier 2 capital under Basel III standards and as progressive capital component under the new Swiss capital adequacy rules.

Safra Group Acquires Majority Interest in Bank Sarasin & Co. Ltd

Reference: CapLaw-2012-46

On 25 November 2011, Safra Group and Rabobank entered into a share purchase agreement under which Safra will acquire a majority shareholding (46.07% equity interest and 68.63% voting rights) in Bank Sarasin & Co. Ltd (Bank Sarasin) for CHF 1,040,000,000 to be paid in cash. The transaction was subject to approval and clearance by the competent authorities in Switzerland and abroad, the last of which was granted on 30 July 2012.

The closing of the sale of Rabobank's majority shareholding in Bank Sarasin to the Safra Group was completed on 31 July 2012. As a result of the closing, Safra Group now holds 50.15% of the share capital and 71.01% of the voting rights of Bank Sarasin. Following Safra's acquisition of the majority stake, Bank Sarasin will in the future be included in the scope of consolidation of J. Safra Holding AG, Basel.

At the Extraordinary General Meeting (EGM) of shareholders of Bank Sarasin on 31 July 2012, shareholders approved all the resolutions submitted by the board of directors, including the election of the new board of directors. Furthermore Safra announced its intention to launch an offer to purchase the publicly held Class B registered shares of Bank Sarasin.

At the beginning of August 2012, JSH S.A. Luxembourg (JSH), a company controlled by Mr. Joseph Y. Safra, announced an all-cash public takeover offer for all publicly held shares in Bank Sarasin at an offer price of CHF 27 per Sarasin Class B share. On 20 August 2012, JSH published the offer prospectus setting forth the terms and conditions of the takeover offer. The offer is expected to close on 19 October 2012.

Mock Trial—Demystifying US Jury Trials

Zürich, 10 October 2012

www.eiz.uzh.ch

Asset Management VI (Vermögensverwaltung VI)

Zurich, 25 October 2012

www.eiz.uzh.ch

Capital Market Transactions VIII (Kapitalmarkttransaktionen VIII)

Zurich, 20 November 2012

www.eiz.uzh.ch