EXCHANGE
REGULATION

Disclosure Office Notice II/13

Disclosure of Equity Derivatives

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Summary:

Equity derivatives with actual delivery

Pursuant to Art. 15, para. 2, letters a and b FMIO-FINMA[1], the acquisition, disposal or granting (writing) of convertible, acquisition and sale rights actually delivered in respect of shares are subject to a notification duty.

A convertible, acquisition and sale right in respect of shares means a right or obligation to acquire and have delivered, or to sale and deliver, shares or holdings equivalent to shares.

Equity derivatives actually delivered that relate to multiple underlyings, and for which only one underlying can be delivered, will not be subject to a notification obligation where there is no significant likelihood of a particular underlying being delivered.

Equity derivatives with cash settlement

According to Art. 15, para. 2, letter c FMIO-FINMA, equity derivatives designed for or permitting cash settlement, and other difference transactions such as contracts for difference and financial futures will be subject to a notification obligation.

Equity derivatives that relate to multiple underlyings and for which the price performance is not largely influenced by a single underlying at the time of concluding the binding transaction which created the rights, or at the time of granting (writing) the derivative, will not be subject to a notification obligation.

Equity derivatives with simultaneous acquisition and sale properties are not subject to a notification obligation providing the parties do not hold an acquisition or sale position in economic terms.

1. Introduction

Upon the FMIA[2] entering into force, the term «financial instrument» was replaced with the term «equity derivative». Legal doctrine and case law concerning financial instruments continues to apply however, where relevant, in accordance with FMIO-FINMA.[3]

There is now a definition of the term «equity derivative» in FMIO-FINMA. Equity derivatives are instruments whose value is derived, at least partially, from the value or price performance of equity securities of companies under Art. 120, para. 1 FMIA.[4]

Classification of an instrument as an equity derivative as defined in Art. 15 FMIO-FINMA does not require listing, standardisation or tradability. This means that equity derivatives that do not fall under the term «securities» as defined in Art. 2, letter b FMIA, may also be subject to the notification obligation. Thus, for example, derivatives created especially for individual counterparties will

[1] Ordinance of the Swiss Financial Market Supervisory Authority on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading (FINMA Financial Market Infrastructure Ordinance, FMIO-FINMA) of 3 December 2015 (CC 958.111).

[2] Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading (Financial Market Infrastructure Act, FMIA) of 19 June 2015 (CC 958.1).

[3] Explanatory report on the Financial Market Infrastructure Ordinance-FINMA (FMIO-FINMA) by the Swiss Financial Market Supervisory Authority FINMA dated 20 August 2015 (Erläuterungsbericht zur Finanzmarktinfrastrukturverordnung-FINMA (FinfraV-FINMA) der Eidgenössischen Finanzmarktaufsicht FINMA vom 20. August 2015), page 29.

[4] Art. 15, para. 1 of the Ordinance of the Swiss Financial Market Supervisory Authority on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading (FMIO-FINMA) of 3 December 2015 (CC 958.111).

be subject to the notification obligation even if such derivatives are not classified as securities. If, within a credit agreement, a collateral agreement is entered into which grants a party the right to purchase a specific, or ascertainable, number of shares, this process may trigger a disclosure obligation even though such a contractual collateral agreement is not to be regarded as a security.

Equity derivatives can be divided into two categories: Equity derivatives that are designed for, or permit, actual delivery, in other words, the delivery of equity securities, and equity derivatives that are designed for, or permit, cash settlement. The list in Art. 15, para. 2 FMIO-FINMA is also not exhaustive. Thus, all equity derivatives with actual delivery or cash settlement that meet the requirements of Art. 15, para. 1 FMIO-FINMA will be subject to the notification obligation.

2. Equity derivatives with actual delivery

2.1. Reportable equity derivatives with actual delivery

Convertible, acquisition or sale rights in respect of shares mean the right of a contracting party to acquire or sell a certain number of shares under certain circumstances, possibly even just by issuing a declaration of intent.

Thus, transactions that involve a right or an obligation to acquire and have delivered, or to sell and deliver, shares or holdings equivalent to shares, will be subject to a notification obligation where their value or price performance is derived, at least partially, from the value or performance of equity securities of companies under Art. 120, para. 1 FMIA. Accordingly, American Depositary Receipts (ADR) for example will be deemed «holdings equivalent to shares».

The conclusion of an agreement to acquire or sell shares changes the share portfolio immediately in terms of disclosure obligations. Consequently, the conclusion of such a contract must be disclosed not as the acquisition or sale of an equity derivative, but, if applicable, as a change to the share portfolio. This applies regardless of whether or not the transaction took place on or off the stock exchange, whether or not the transaction is conditional or whether or not fulfilment is agreed upon at a later time.

From the standard call or put option (so-called plain vanilla option)[5] to option strategies that combine plain vanilla options, exotic options with additional contractual terms and conditions when compared with plain vanilla options, and structured products consisting of different, sometimes exotic, options, all equity derivatives will always be subject to the notification obligation. Under Art. 15, para. 2, letters a and b FMIO-FINMA, instruments that are designed for, or at least permit, actual delivery, in other words, a delivery of equity securities, e.g. shares, are classified as equity derivatives with actual delivery. Thus, under this heading, products relating to multiple underlyings, such as basket or index products, will also always be subject to notification obligations where these are designed for, or permit, the delivery of equity securities.

2.2. Examples of reportable equity derivatives with actual delivery

It is not possible to exhaustively list all equity derivatives which are subject to notification obligations. Thus, just a few examples of equity derivatives with actual delivery that are required notification are indicated hereinafter (Art. 15, para. 2, letters a and b FMIO-FINMA)[6].

- Call and put options and warrants[7]

[5] For the purposes of this notice, «plain vanilla options» means equity derivatives that entitle, but do not oblige, the purchaser to acquire (plain vanilla call option) or sell (plain vanilla put option) a specific underlying in a defined quantity on or by a specified date in the future at a fixed price.

[6] The classification by the Swiss Structured Products Association (SSPA) may be helpful here.

[7] For the purposes of this notice, «warrants» means securitised options.

- Convertible bonds or warrant bonds
- Option strategies (e.g. bull call spread[8])

Specified here as examples of exotic options:

- Path-dependent options[9] such as barrier options[10]
- (Strike) lookback options[11]

Specified here as examples of structured products:

- Participation products such as tracker certificates[12]
- Yield enhancement products, such as share discount certificates[13]
- Yield enhancement products, such as barrier reverse convertibles[14]

2.3. Non-reportable equity derivatives with actual delivery

Certain equity derivatives that are designed for, or permit, actual delivery, are not subject to the notification obligation even though they entitle or oblige the holder or writer to acquire or sell equity securities.

Example: Multiple underlyings – uncertain delivery

Equity derivatives that concern multiple underlyings, for which only one of these underlyings (alternative) can be delivered, are not subject to the notification obligation where there is no significant likelihood that a particular underlying will be delivered. Equity derivatives that concern multiple underlyings, but for which an underlying cannot be delivered, but a different equity security instead, are also not subject to the notification obligation where there is no significant likelihood that a particular equity security will be delivered.

In other words, such an instrument is denied the quality of an acquisition or sale right in relation to a specific equity security. Such an instrument is therefore not subject to the notification obligation.

The relevant time to determine whether or not there is a significant likelihood of delivery of a particular equity security is the time of completing the binding transaction which formed the basis of the rights or the time of granting (writing) the equity derivative in question. If there is no notification obligation at that time, the corresponding transaction will not trigger any notification obligation later either, even if the relevant price performance means that an equity security is actually acquired. Whether or not the acquisition of equity securities by exercising the corresponding equity derivative triggers a notification obligation must be examined separately.

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[8] For the purposes of this notice, «bull call spread» means a combination of two call options in which one call option for a share is acquired and the other call option (over the same share) is written with a higher exercise price. Both options have the same expiry date.

[9] For the purposes of this notice, «path-dependent options» means options for which the price of the underlying is significant not only at the time of expiry of the option and at the time of the exercise of the option, but also for which price fluctuations of the underlying are incorporated throughout the life of the options.

[10] For the purposes of this notice, «barrier options” means options that are activated or expire when a certain barrier is reached, exceeded or fallen below.

[11] For the purposes of this notice, «(strike) lookout options» means options in which the lowest value (call option) or highest value (put option) of the underlying determines the exercise price.

[12] For the purposes of this notice, a «tracker certificate» means a structured product that reflects the performance of the underlying in question exactly. The interest of the investor will therefore follow all price movements in the underlying without limitation.

[13] For the purposes of this notice, a «share discount certificate» means a structured product which entitles the investor to a share at a price (discount) that is below the current market price. At the same time the maximum possible yield from the structured product is limited to a specified maximum (cap). If the share price is below the maximum amount at the end of the term, the investor will usually receive the share.

[14] For the purposes of this notice, «barrier reverse convertible» means a structured product for which the underlying is delivered if the corresponding barrier is touched or fallen below during the term and if the price of the underlying is the same or lower at the end of the term than the corresponding exercise price. The investor is granted a coupon payment.

The exemption described therefore applies to equity derivatives that concern multiple underlyings and for which alternatively only one underlying (or a different equity security) can be delivered, where there is no significant likelihood of a particular underlying (or a particular equity security) being delivered. If an equity derivative provides for a (conditional or unconditional) delivery of multiple different equity securities however and not just the (potential) delivery of one (not yet specific) equity security, the exemption above will not apply. Such an equity derivative is subject to a notification obligation in respect of each equity security for which (conditional or unconditional) delivery has been agreed upon.

Thus, equity derivatives for which there is no significant likelihood of a particular equity security being delivered are not subject to the notification obligation. Such, for example, will be the case of a barrier reverse convertible comprising at least two underlyings (which do not have extremely different volatilities), each with the same (percentage) barrier, and where delivery of the underlying with the poorest performance only is provided for. The acquisition of such a barrier reverse convertible will not trigger a notification obligation. If, on the other hand, substantially different barriers are provided for in relation to the underlyings at the time of issue, e.g. 30 percent for one underlying and 70 percent for the other, the acquisition of this barrier reverse convertible will mean that the acquisition of the second underlying must be reported.

Example: Equity derivatives with acquisition and sale components

The issue of classifying an equity derivative as an acquisition or sale right arises for instruments which, at the time of completing the binding transaction giving rise to the rights, or at the time of granting (writing), provide for both an acquisition and a sale component, and for which the underlying results in an acquisition right or a sale right depending on changes in the price of the underlying. Where, in such instruments, the acquisition and sale components have the same weighting and are inextricably linked, such instruments will not be classified as either acquisition rights or sale rights where, at the time of completing the binding transaction which gave rise to the rights, or at the time of granting (writing), there is no significant likelihood that the equity derivative will enable either an acquisition or disposal of equity securities. Such equity derivatives are therefore not reportable.

On the other hand, it may be advisable to jointly consider two or more equity derivatives as a single equity derivative. As a general rule, opposing positions procured through various equity derivatives may not be «offset». This so-called «ban on netting» arises from Art. 14, para. 1 FMIO-FINMA. According to this provision, acquisition and sale positions must be calculated and reported individually and separately from one another. If the equity derivatives and the relevant acquisition and sale components contractually agreed upon between the contracting parties are inextricably linked however, these are to be examined in a consolidated manner. Such an inextricable link can then be assumed when an equity derivative is only agreed on the condition («conditio sine qua non») that another equity derivative is also agreed upon, and where the equity derivatives thus represents a single, inseparable transaction. The question of whether such inextricably linked equity derivatives predominantly enable or initiate an acquisition or sale of equity securities must be answered in such cases with joint consideration of the equity derivatives linked in this manner.

3. Equity derivatives with cash settlement

3.1. Reportable equity derivatives with cash settlement

Art. 15, para. 2, letter c FMIO-FINMA stipulates that equity derivatives which are designed for, or permit, cash settlement, as well as other difference transactions, such as contracts for difference and financial futures with cash settlement, must be reported.

This definition of the equity derivatives with cash settlement that are subject to the notification obligation is extremely broad. Only equity derivatives with a connection to equity securities that must be disclosed, in the sense that the value of such equity derivatives depends directly or indirectly, in full or to a large extent, on the value of such equity securities, can be subject to the notification obligation under Art. 15, para. 2, letter c FMIO-FINMA. In the absence of such a connection to corresponding equity securities, there will be no notification obligation.

3.2. Examples of reportable equity derivatives with cash settlement

Essentially, the examples given above for reportable equity derivatives with actual delivery can be referred to[15]. Again with reportable equity derivatives with cash settlement, it is impossible to provide an exhaustive list hereinafter. Possible examples of reportable equity derivatives with cash settlement are:

- Contracts for difference[16]
- Equity swaps[17]
- Options / warrants with cash settlement
- Futures[18] / forwards[19] with cash settlement

3.3. Non-reportable equity derivatives with cash settlement

Essentially, the same restrictive interpretation applies to equity derivatives with cash settlement as to equity derivatives with actual delivery[20].

Unlike actually delivered equity derivatives with multiple underlyings however, with equity derivatives with cash settlement, there is no need to question whether or not there is a significant likelihood of a particular underlying being delivered. Instead, the question is whether or not the price performance of the instrument is largely influenced by an underlying. Whether the payout scenario is determined by one or more, or all, of the underlyings under the terms of the equity derivative is irrelevant here.

When assessing the notification obligation for equity derivatives with cash settlement that provide for both an acquisition and a sale component, an economic approach must be applied. If either an acquisition or sale results with such equity derivatives, when considered economically, depending on the price development, and if acquisition and sale components are weighted equally and are inextricably linked, then the corresponding equity derivatives will not be subject to the notification obligation if, at the time of completing the binding transaction forming the basis of the rights, or at the time of granting (writing), there is no significant likelihood of either the acquisition scenario or the sale scenario.

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[15] See no. 2.2 above.

[16] For the purposes of this notice, «contracts for difference» means agreements that pay out the current difference between the purchase and sale price of the underlying to the winner on a specific due date.

[17] For the purposes of this notice, «equity swap» means an instrument in which one party undertakes to pay the return from a share price on a notional nominal capital, while the other party undertakes to pay a fixed or variable return on a notional nominal capital.

[18] For the purposes of this notice, «futures» means an agreement regarding the acquisition or sale of a specific item, in a specific quantity, and at a specific time in the future, at a fixed price already determined at the time of concluding the agreement. Futures are traded through stock exchanges.

[19] For the purposes of this notice, «forwards» means an agreement regarding the acquisition or sale of a specific item, in a specific quantity, and at a specific time in the future, at a fixed price already determined at the time of concluding the agreement. Forwards are not traded through stock exchanges.

[20] See no. 2.3 above.

4. Calculation of the percentage of voting rights

Art. 14, para. 1 FMIO-FINMA states that acquisition and sale positions must be calculated individually and separately from one another. This means that opposing positions for a particular underlying may not be offset. According to Art. 14, para. 2 FMIO-FINMA, the total number of voting rights according to the entry in the commercial register should be used as the basis (100 percent) for calculating whether a threshold has been reached, fallen below of or exceeded. In the case of companies with their registered office abroad, the publication required under Art. 115, para. 3 FMIO[21] is decisive for calculating the reportable positions (see also the Disclosure Office Notice dated 26 February 1999 III/99 – amended version of 20 September 2018).

The percentage must be calculated on a nominal basis in case of both equity derivatives with actual delivery and equity derivatives with cash settlement, in other words, on the number of shares the equity derivative relates to. This means that whether the equity derivatives are «in the money» or «out of the money» upon issue or during their term is irrelevant for calculating the voting share percentage of equity derivatives.

If the equity derivative comprises of multiple components that are inextricably linked, and where only one or another of them may be exercised, then not every component will be included in full for the calculation of the percentage of voting rights. Instead, the maximum possible number of shares the derivative can relate to will be used as the basis.

A so-called «collar» can be given as an example of this. In this case, a shareholder secures their share position by purchasing put options with a lower exercise price and simultaneously granting (writing) call options with a higher exercise price. The number of shares the put options and call options relate to, and the exercise deadlines, are identical. In this scenario, only the call options or the put options will be exercised because they cannot both be «in the money» at the same time. In other words, the maximum possible number of shares that the equity derivative can relate to is the number of shares the put options relate to or that the call options relate to – both option types relate to the same number of shares. This number of shares, to which the put or call option relates, must therefore be used to calculate the percentage of voting rights.

In case of transactions involving equity derivatives for which the precise number of shares to which the equity derivatives relate is not yet certain at the time the notification obligation arises because, for example, this figure depends on a future share price, the maximum number of shares to be delivered must generally be reported[22]. If such a calculation of the positions requiring notification results in unclear or infeasible results (e.g. to values over 100 percent of the voting rights), or if the maximum number of shares to be delivered cannot be determined, then the party responsible for the notification has the alternative option of calculating the number of shares to which the equity derivative relates based on the figures which are current on the date the notification obligation arises. For example, if the number of shares to which an equity derivative relates depends on the share price at a future date, then the reporting party may use the closing price for the share on the date the notification obligation arises as a basis for the purposes of calculating whether a threshold has been reached, fallen below or exceeded, and any positions to be reported. If there is no closing price for the day on which the notification obligation arises, the calculation may be done based on the last closing price prior to the notification obligation arising.

If the latter calculation option is used, the disclosure notification must state that the positions requiring notification have been calculated based on information on the day the notification obligation arose. The formula used to calculate the actual number of shares to be delivered must also be

[21] Ordinance on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading (Financial Market Infrastructure Ordinance, FMIO) of 25 November 2015 (CC 958.11).

[22] See the Disclosure Office Annual Report, no. 3.2.1.1, page 25.

specified. The party responsible for the notification is also obliged to recalculate the position reported in this manner based on the current information on the first trading day of every month. If the positions of the party reach, exceed or fall below a threshold under Art. 120, para. 1 FMIA based on this recalculation, a notification obligation will be triggered. In this case, the date the notification obligation arises will be the date of the recalculation, in other words the first trading day of the month in question, and the notification must be submitted to the company and the disclosure office within four trading days in accordance with the provisions of FMIO-FINMA. The situation triggering the notification obligation must then be specified as «change in the information subject to the obligation to notify».

This notice has been brought to the attention of the Swiss Financial Market Supervisory Authority FINMA prior to publication.