

Circular 2013/8

Market conduct rules

Supervisory rules for market conduct in securities trading

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 Concordance: former FINMA-Circ. 08/38 "Market conduct rules" of 20 November 2008
 Legal framework: FINMASA Articles 7 para. 1 let. b, 27, 29
 BA Articles 3, 3f
 BO Article 9
 SESTA Articles 1, 2, 3, 4, 10, 33e, 33f, 34
 SESTO Articles 19, 20, 55a-55f
 CISA Articles 13, 14, 20, 28, 72
 CISO Articles 10, 12, 33
 ISA Articles 14, 22, 30, 67, 75
 ISO Articles 78, 96, 97, 105, 106
 AMLA Article 14 para. 2 let. c

		Addressees																					
BA			ISA			SESTA			CISA						AMLA			Other					
Banks	Financial groups and congl.	Other intermediaries	Insurers	Insurance groups and congl.	Insurance intermediaries	Exchanges and participants	securities dealers	All other market participants	Fund management companies	SICAVs	Limited partnerships for CISs	SICAFs	Custodian banks	Asset managers CISs	Distributors	Representatives of foreign CISs	Other intermediaries	SROs	DSFIs	SRO-supervised institutions	Audit firms	Rating agencies	
X	X		X	X		X	X	X	X	X	X	X	X	X					X				

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I. Purpose

The Federal Act on Stock Exchanges and Securities Trading (Stock Exchange Act, SESTA) ensures transparency and the proper functioning of securities markets and equality in the treatment of investors. To this end, Section 5a SESTA sets out market conduct that is not permissible under supervisory law by prohibiting the misuse of insider information as well as market manipulation. 1

This Circular sets out details regarding the market conduct prohibited under SESTA (Arts. 33e and 33f SESTA; SR 954.1) as well as the implementing provisions of the Stock Exchange Ordinance (Art. 55a ff SESTO; SR 954.11). It also specifies the requirement for assurance of proper business conduct in the specific context of market conduct and establishes organisational requirements for supervised institutions. Compliance with these rules should ensure that prohibited market conduct is prevented and identified. 2

II. Scope of application

Sections III-V of this Circular apply to all individuals and legal entities acting as market participants in connection with securities admitted to trading on Swiss exchanges or exchange-like trading venues. 3

Sections VI (Market abuse on the primary market, with foreign securities or on other markets) and VII (Organisational requirements) of this Circular apply to the following institutions supervised by FINMA: banks, insurance companies, exchanges and exchange-like trading venues, securities dealers, fund management companies, SICAVs, limited partnerships for collective investment, SICAFs, custodian banks and asset managers of collective investment schemes. 4

With regard to financial groups and conglomerates as well as insurance groups and conglomerates, sections VI (Market abuse on the primary market, with foreign securities or on other markets) and VII (Organisational requirements) of this Circular apply to parent institutions domiciled in Switzerland as well as to other domiciled institutions of a group or conglomerate in Switzerland where FINMA has declared itself responsible for supervising the group or conglomerate. 5

Section VI (Market abuse on the primary market, with foreign securities or on other markets) of this Circular also applies to directly subordinated financial intermediaries in addition to the supervised institutions listed in margin nos. 4 and 5. 6

The terms in brackets used in this Circular only serve to facilitate understanding of the market abuse described; the description set out in the margin numbers concerned is authoritative. 7

III. Insider information (Art. 2 let. f SESTA)

Information refers to facts including firm intentions, as yet unrealised plans and prospects. Facts external to the company, such as knowledge of a financial analysis awaiting publication, a large customer order, a licence or authorisation that is to be granted or refused or a planned terror attack, are also deemed to constitute information. Rumours and speculation, on the other hand, do not constitute information. Information must be sufficiently clear and certain that it may provide a basis for anticipating the future trend in the price of a security. 8

Information is deemed to be confidential if it is not generally available and is instead only available to a restricted group of people. Information is deemed to be in the public domain if unconnected third parties are able to obtain it from generally accessible sources. A rumour does not in principle set aside the confidentiality of specific information. 9

The question of whether or not information is price-sensitive, i.e. capable of substantially influencing the market price of securities, is to be decided on a case-by-case basis with reference to whether or not the information is capable of influencing the investment behaviour of a reasonable investor who is familiar with the market. In principle, substantiality is assessed according to the market situation prior to the information being known. 10

A recommendation within the meaning of Article 33e para. 1 let. c SESTA is deemed to constitute insider information in accordance with Article 2 let. f SESTA if the recipient knows or, given the circumstances (e.g. the special knowledge or position of the person making the recommendation) can be expected to know that the recommendation derives from insider information. 11

IV. Misuse of insider information (Art. 33e SESTA)

Derivative financial instruments under Article 33e para. 1 SESTA also include non-standardised over-the-counter (OTC) products. The question of whether a transaction in financial instruments is made on or off an exchange or an exchange-like trading venue is immaterial for the purpose of determining misuse of information. It is equally immaterial whether the financial instruments are traded in Switzerland or abroad if they are derived from securities admitted to trading on an exchange or exchange-like trading venue in Switzerland. 12

Securities trades that were demonstrably not executed on the basis of confidential and price-sensitive information, despite such information being known, and would indeed have been executed even without such knowledge do not constitute misuse of insider information. 13

Altering or cancelling an order relating to a security or financial instruments derived from it 14

on the basis of insider information does constitute misuse of insider information if the original order was issued before the insider information was known.

Taking advantage of the expected market reaction of market participants and of securities prices in the knowledge of an impending announcement of investment recommendations (“scalping”) also constitutes a violation of Article 33e para. 1 let. a SESTA if the recommendations in question are capable of significantly influencing the market price of securities in accordance with Article 2 let. f SESTA. 15

V. Market manipulation (Art. 33f SESTA)

Public dissemination of information includes in particular announcements made via the financial sector’s usual information channels, the media and the internet. 16

A signal falls within the meaning of Article 33f SESTA if it is capable of influencing the market behaviour of a reasonable investor who is familiar with the market. 17

Market manipulation in accordance with Article 33f SESTA may also involve the use of algorithmic trading programs, particularly in the context of algorithmic high-frequency trading. Anyone engaging in algorithmic trading may not use it to give out false or misleading signals regarding the supply of, demand for or market price of securities. 18

The following are examples of conduct that particularly violate Article 33f SESTA: 19

- Disseminating false or misleading information on circumstances of substantial importance for the valuation of a security (e.g. a company’s earnings, orders or product pipeline or a general supply shortage). 20
- Disseminating false or misleading information, rumours or messages that are capable of influencing securities prices in order to exploit the resulting price movement. 21
- Entering low-volume purchase orders with successively higher prices in order to simulate increased demand amid rising prices (painting the tape). 22
- Simultaneously buying and selling the same securities for the account of one and the same beneficial owner in order to give out false or misleading signals regarding the supply of, demand for or market price of securities (wash trades). 23
- Entering equal but opposite buy and sell orders in the same security by prior mutual agreement in order to distort liquidity or prices (matched orders or daisy chains coordinated among a number of parties). 24
- Constricting the market by building up large positions (cornering) or depositing securities with third parties (parking) in order to distort securities prices (creating a squeeze). 25

• Buying or selling securities shortly before the exchange closes in order to influence closing prices (marking the close).	26
• Buying or selling securities in order to move prices (ramping) or keep them at a specific level (e.g. capping, pegging), unless this is done to stabilise prices following a public placement of securities in accordance with Article 55e SESTA.	27
• Influencing commodity prices in order to give out false or misleading signals regarding the supply of or demand for securities.	28
• Creating an overhang of buy or sell orders by entering large orders in the order book that are capable of influencing prices in order to influence the valuation of a security.	29
• Placing orders in the trading system in order to create an illusion of supply or demand and then deleting them prior to execution (spoofing, layering).	30
The following are specifically permissible securities trades and conduct:	31
• Market making for the purpose of ensuring liquidity in a security on both buy and sell sides and, where appropriate, reducing the bid/ask spread.	32
• Issuing parallel buy and sell orders in the same financial instrument or different financial instruments (e.g. on different trading venues) for the purpose of arbitrage.	33
• Offering liquidity (liquidity providers, e.g. algorithmic trading), provided the order book entries and trades do not give out misleading signals for other market participants.	34
• Nostro-nostro in-house crosses where equal and opposite trades are matched in the stock exchange system independently of one another and without any previous agreement.	35
• Not deleting prices that have already been provided when trading is suspended in connection with buybacks under Article 55b para. 2 let. e SESTA and price stabilisations under Article 55e let. d SESTA.	36
No violation of Article 33f SESTA is assumed in the following cases:	37
• Securities trades with a demonstrable economic background that correspond to genuine bid and ask behaviour.	38
• Use of a volume-weighted average price (VWAP) algorithm to repurchase securities during a buyback.	39
It is assumed that the parties involved in price stabilisation in connection with a public placement of securities do not violate Article 33f SESTA if the issuer of the securities, which is itself not involved in the public placement, fails to meet its reporting obligations under Article 55e lets. e and f SESTO, provided the parties that are involved comply with all	40

other “safe harbour” rules.

VI. Market abuse on the primary market, with foreign securities or on other markets

For the purpose of assessing the assurance of proper business conduct on the part of the supervised institutions listed in margin nos. 4 and 5 and with a view to applying measures in accordance with Articles 29-37 of the Financial Market Supervision Act (FINMASA; SR 956.1) and Article 35a SESTA, the provisions on insider information and market manipulation (sections III-V) of this Circular) apply not only in respect of securities admitted to trading on Swiss exchanges, but also *mutatis mutandis* in respect of the following in particular: 41

- Securities trading on the primary market 42
- Securities that are only admitted to trading on an exchange or exchange-like trading venue outside Switzerland as well as financial instruments derived from such securities 43
- Trading on markets other than the securities market (e.g. commodity, foreign exchange and interest rate markets), particularly in connection with benchmarks. 44

VII. Organisational requirements

A. Scope

The supervised institutions listed in margin no. 4 and 5 must meet the organisational requirements set out in this section in line with their risk situation. Risk is assessed in terms of specific business activity, size and structure. The organisational requirements expand on the licensing requirements stipulated in the financial market laws regarding assurance of proper business conduct and organisation as well as the duty to provide information stipulated in Article 29 para. 2 FINMASA. 45

Supervised institutions must assess the risks arising within the scope of this Circular once a year and additionally on an ad-hoc basis as required. The organisational measures required to comply with this Circular are then defined on the basis of the risk assessment. The risk assessment and the measures must be signed off by the supervised institution’s executive governing bodies. 46

B. Dealing with market abuse

Where there are clear indications that securities trades for clients may not comply with the requirements set out in Articles 33e and 33f SESTA or sections III–VI, supervised institutions must clarify the background to such trades and, if necessary, refuse to be 47

involved in them, although systematic monitoring and investigation of clients' securities trades is not required. In the case of securities trades in accordance with Article 40 para. 2 or Article 40a para. 2 SESTA, their status as predicate offences to money laundering means that Article 19 of FINMA's Anti-Money Laundering Ordinance (AMLO-FINMA; SR 955.033.0) applies.

Trades that are contrary to Article 33e or Article 33f SESTA and are capable of having a substantial impact on the risks of a supervised institution or the financial sector as a whole must be reported to FINMA (Art. 29 para. 2 FINMASA). 48

C. Information barriers / areas of confidentiality

The handling of insider information is to be organised and monitored such that market conduct prohibited under supervisory law can be prevented and identified. To this end, supervised institutions must have adequate and appropriate organisation, training and controls in place. 49

By putting in place appropriate and effective internal precautions and processes, supervised institutions ensure that the individuals with the power of decision over trading in securities and other financial instruments about which the supervised institution possesses insider information have no knowledge of this insider information. They also ensure that individuals who do have knowledge of insider information are not able to influence decisions concerning trading in the securities or other financial instruments to which the insider information pertains. 50

Appropriate and effective precautions in accordance with margin no. 50 include in particular measures regarding premises, staff, functions, organisation and information technology that are intended to create areas of confidentiality within which information can be isolated and controlled. Such precautions must be set out in internal directives or, if necessary, taken on an ad-hoc basis. A suitable function (e.g. Compliance) must be assigned responsibility for monitoring adherence to these precautions. 51

Where insider information is isolated within areas of confidentiality, securities trades may still be carried out in other organisational units. 52

D. Surveillance of employee transactions

Supervised institutions must take measures for the surveillance of employee transactions. These measures must in particular be capable of preventing employees from misusing insider information in transactions for their own account and of identifying such misuse. Due attention must be paid to all custody accounts and related cash accounts held by employees with the supervised institution or a third-party institution as well as those for which employees have beneficial ownership or power of attorney. 53

For the purpose of these rules, employees are defined as all members of the supervised institution's staff, together with the members of governing bodies responsible for directing, 54

supervising and controlling, the executive management, partners with unlimited liability and anyone with a comparable function.

Supervised institutions must set out their appropriate and suitable surveillance measures in an internal directive. Different levels of surveillance may be applied to different categories of employees or functions in line with the risk of misuse of insider information. Regardless of such risk categories, supervised institutions must ensure that they can access information on all relevant cash and custody accounts whenever necessary. 55

E. Watch list and restricted list

Supervised institutions must keep a *watch list* and a *restricted list*. 56

The *watch list* contains details of the insider information the supervised institution possesses about issuers and in particular the individuals in possession of such information and the period of time for which it must remain confidential. It must be kept by an appropriate function specifically designated as responsible for it (e.g. Compliance). 57

The *restricted list* provides information on bans or restrictions on specific trading activities, such as in particular bans on transactions in specific securities, blocked transactions, or publishing restrictions pertaining to financial analysis. The function responsible for the *watch list* is also responsible for the *restricted list*. 58

F. Documentation and recording requirements

Where there are clear indications that trades may not meet the requirements of Article 33e and 33f SESTA or sections III-VI above, such trades must be documented. 59

The external and internal telephone calls of all employees working in securities trading, including those made on mobile telephones, must be recorded. The use of means of communication that cannot be recorded must not be allowed. Recordings must be kept for at least two years and made available to FINMA without alterations as required. 60

Electronic correspondence (e-mail, communication via Bloomberg or Reuters etc.) and itemised lists of business calls by all employees working in securities trading as well as by employees deemed by the risk assessment to be especially likely to receive information of relevance for market supervision must be kept for at least two years and made available to FINMA without alterations as required. 61

G. High-frequency / algorithmic trading

Supervised institutions that engage in algorithmic trading (see margin no. 18) must employ effective systems and risk controls to ensure that this cannot result in any false or misleading signals regarding the supply of, demand for or market price of securities. 62

Supervised institutions must document the key features of their algorithmic trading strategies in a way that third parties can understand. 63

H. Audit

The organisational requirements for supervised institutions are audited in accordance with FINMA-Circ. 13/3 “Auditing”, those for exchanges by the audit firms engaged under Article 17 SESTA. Where violations of market conduct rules are detected during the audit, these must be reported to FINMA in accordance with Article 27 FINMASA or Article 30 ISA (SR 961.01) and mentioned in the audit report. 64

VIII. Entry into force and transitional provisions

This Circular enters into force on 1 October 2013. 65

Once it is in force, this Circular replaces FINMA-Circ. 08/38 “Market conduct rules”. 66

The organisational requirements must be met by 1 January 2015. Until then, the organisational requirements set out in FINMA-Circ. 08/38 “Market conduct rules” continue to apply. The first risk assessment in accordance with margin no. 46 must be completed by 1 April 2014 at the latest. 67