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# Ethics in the financial markets – lessons from the Swedish Securities Council

## Introduction

The Swedish Securities Council is a part of the system of self-regulation of the Swedish stock market. The purpose of this system is to promote best practices in the stock market.

Sweden has a long tradition of self-regulation on the stock market. Half a century ago, at the end of the 1960's, the Swedish Industry and Commerce Stock Exchange Committee (*Sw: NBK*) was formed in order to establish best practices in the Swedish stock market by issuing recommendations (or, in practice, rules) regarding various stock market-related issues. In this way, Sweden was earlier than most continental European countries in promulgating rules governing, among other things, takeover bids, disclosures of large stock holdings, prospectuses, share redemptions, and so on. Great Britain provided the model used by Sweden for many of these rules.

As a consequence of EU directives, most of the Stock Exchange Committee rules have now been replaced by legislation, but there is still room in the stock market area for recommendations and other rules created within the context of the system of self-regulation.

This article will not, however, discuss self-regulation on the stock market as a whole. Rather, I will focus on a specific component of the system of self-regulation, namely the Swedish Securities Council (*Sw: Aktiemarknadsnämnden*).

## The Securities Council

The Securities Council was created against the backdrop of an intense public debate on unethical conduct in the stock market, which reached its culmination in the autumn of 1985 with the so-called "Leo Affair". The affair – which involved executive compensation – drew a great deal of attention in the public debate, and politicians felt compelled to take action. The Swedish Government set up a commission which proposed a major sharpening of the pertinent rules in the Swedish Companies Act. And the business community, which was then facing a severe crisis of confidence, also took it upon itself to establish a special body which could issue statements on a case-by-case basis regarding what constituted best practices in the stock market.

While the Stock Exchange Committee pursued its mission by issuing recommendations or rules of general application, the Securities Council

would issue statements, advice and information predominantly in the context of individual cases.

Today, self-regulation is organised somewhat differently and more broadly established than was the case in the beginning. Nowadays, self-regulation on the Swedish stock market is the responsibility of an association - the "Swedish Association for Best Practices in the Securities Market". The Association has nine members: The Confederation of Swedish Enterprise, the Association of Listed Companies, NASDAQ OMX Stockholm, the Securities Dealers' Association, the Institute of Authorised Public Accountants, the Bankers' Association, the Insurance Federation, the Investment Fund Association and the Institutional Owners Association for Regulatory Issues in the Stock Market.

The Securities Council commenced operations in the autumn of 1986. Within the context of its mission, the Council may examine any action taken by a Swedish listed company or a shareholder of such a company if the action relates to a share in the company or may be relevant to the assessment of the share. To a certain extent, the Council may also examine such actions by foreign companies provided the company's shares are admitted to trading on the Swedish stock market.

## Statements by the Council

The public debate leading up to the establishment of the Council gave the impression that there was ample need for an impartial body

to which – not the least – the investing public could turn for a determination whether certain marketplace practices were compatible with good stock market ethics. The instigators appear to have expected a torrent of petitions as soon as Council operations got underway, mostly from small, individual shareholders. This did not turn out to be the case.

During the first years of operation, there were fewer petitions than expected, amounting to only approximately ten matters per year. The trend was also negative – the number of petitions filed declined. In 1993, the Council addressed one single matter.

However, this trend turned in the middle of the 1990's. The influx of petitions began to steadily rise and, at present, an internal rule of thumb applied by the Council´s Secretariat is to plan for an average of approximately one petition a week.

So then, what types of issues does the Council address? After just a few years, two well-defined problem areas could be discerned, and there was a third area consisting of the remaining issues. The very first statement concerned public takeover bids. Issues along these lines regularly arose and soon constituted a distinct and growing problem area. Another problem area involved queries about incentive schemes and other types of share-related remuneration structures, principally for senior executives. The third and final area may be best described as covering other issues relating to minority protection, such as targeted share issues, share buy back programs, amendments of bylaws etc.

Currently, the vast majority of the matters addressed by the Securities Council involve public takeover bids. This reflects changes in takeover activity on the stock market as well as, among other things, the fact that the regulatory regime pertaining to such bids has developed considerably over time and undergone a legal "upgrade".

With the implementation of the EU Takeover Directive in 2006, the rules regarding public takeover bids on the Sweden stock market took on a new legal form. Certain basic rules concerning takeover bids for companies whose shares were admitted to trading on a regulated market were embodied in law, the exchanges were required to have takeover rules, and the Swedish Financial Supervisory Authority was designated as the competent supervisory authority. As a consequence, the tasks of the Council in these respects are to some extent currently legally regulated and delegated. It is an interesting example of the interplay between legislation and self-regulation.

Contrary to what was originally expected, it was also not chiefly the individual, small shareholders or their interest group organisations which turned to the Council for a determination of various marketplace practices. Of course it happens that the Council also addresses such matters on occasion, but most of the matters dealt with by the Council are initiated by companies or major owners and concern planned measures such as, for example, planned takeover bids, planned incentive programmes, or planned issues of new shares or other financial instruments.

Questions concerning such *planned* actions typically arise as a result of genuine uncertainty about what the rules or best practices dictate

in a particular case at hand. For example, an offeror is considering the formulation of a planned tender offer in some respect - perhaps the conditions for completion - and seeks to know whether the use of one or more such terms is compatible with the takeover rules and best practices in the stock market; or a company is contemplating an executive incentive programme and wishes to know whether certain details of the programme are compatible with best practices in the stock market; or a company is pondering a new issue of financial instruments on the international capital market and wants to find out whether certain terms of the issue are compatible with good practices in the stock market; and so on.

However, it also happens that the company or individual initiating the matter has a fairly clear and well-founded opinion on the matter but wants a statement by the Council to fall back on in the event the matter is subsequently challenged.

Queries concerning actions which have *already been taken* – that is, where the individual or company seeks to know whether a certain step actually is or was compatible with best practices in the stock market - have been much less common than was anticipated at the outset. Individual shareholders have made only a few inquiries of this type. Furthermore, the Swedish Shareholders' Association (*Sw: Aktiespararna)* has initiated only ten or so matters over the years. Most interesting, however, is the fact that the Stock Exchange has turned to the Council in recent years on several occasions in order to determine whether certain steps taken by listed companies are compatible with best practices.

Finally, it should be mentioned in this context that it is increasingly common that a party involved in a hostile takeover calls into question the steps taken by another party and wonders whether, for example, actions by a competing bidder or the target company are compatible with the takeover rules and best practices in the stock market. Last year, there was a contest between two companies in the oil industry who had made bids for each other – the contest gave rise to not less than nine sizeable matters before the Council. In fact, it went so far that the Council explained in a sternly formulated letter to both companies that their actions had undermined confidence in the Swedish stock market and urged them to attempt to quickly reach an agreement regarding control of the companies.

In order for the Council to effectively pursue its mission of promoting best practices in the stock market, it is necessary that its decisions be a matter of public record. Accordingly, a determination by the Council of a matter should result in a written statement, which should, as a main rule, be immediately published. However, as regards certain matters, the Council may under certain circumstances decide to keep the ruling confidential for the time being.

Statements which are not immediately made public nearly always involve planned transactions which have not yet been carried out. Also, in certain cases, it is obvious that the transaction will not be carried out as planned since the decision by the Council goes against the company or individual initiating the matter in some decisive way.

Since its start, the Council has made a total of nearly 800 statements. Approximately three-quarters of these are public, and the Council is

working to obtain approval from relevant parties in order to publish older statements.

## What are best practices?

What are best practices in the stock market? The question has no meaningful or practicable, general answer. It can only be answered on a case-by-case. In this regard, neither the original nor current rules governing the activities of the Council provide any guidance regarding the considerations to be made by the Council.

It is obvious that as regards issues which are ultimately subject to an applicable legal rule and the issue of best practices has perhaps come up in relation to an attempt to circumvent such legal rule or touches upon whether best practices require that the rules be applied analogously to a situation which is not covered by the statutory text, best practices often involve supplementing the rules with an additional layer of protection by filling the gaps in the regime intentionally or unintentionally left by the legislature.

Hence, guidance as to what constitutes best practices may often be obtained from the intention underlying the relevant rules. Anyone who wishes to adhere to best practices in the stock market would be wise to set aside any thoughts about taking the rules on face value and the possibility of cunningly circumventing such rules. Quite the contrary, best practise is frequently a matter of being loyal to the intentions of the rulemaker.

In certain cases, however, there are no rules to be relied on or start from when answering the question: What are best practices? It then falls on the Council to make this determination based on its combined, wide-ranging experience gained over many years.

What the Council declares to be best practices naturally applies in respect of the future in the sense that, when the statements are published, market participants are expected to thereafter uphold them. However, these statements also frequently express what the Council considers to be already existing best practices. In these latter cases, the Council may also be critical of actions which have already been carried out in contravention of best practices.

## Organisation and decision-making process

The Securities Council's tasks place high demands on the Council's composition. It must reflect the various interests present in the business community and on the stock market such that the decisions taken by the Council are (and are perceived to be) well-founded. The members must be highly knowledgeable and have extensive experience within their respective fields. But this is only the start. The members must also have integrity and, not the least, feel responsible for "best practices in the stock market".

The Council currently has 30 members. It includes judges, legal and financial advisors, representatives of various categories of investors and corporate leaders.

The members are appointed for consecutive periods of two years with the possibility of an extension. In total, slightly more than 80 persons have participated in the work of the Council at some point during the 30 years the Council has been in existence.

The Chairman of the Council has a particularly important role in the Council's activities as the one who conducts the meetings of the Council and as the sole decision taker on certain types of matters. When the Council was established, it was decided that its Chairman must have extensive legal knowledge and judicial experience. Over time, those criteria have become increasingly important. The legal regime on which the Council principally bases its considerations has gradually become more jurisprudentially complex. In addition, the Council is to an ever greater extent faced with procedural issues which require an understanding of the administration of matters in courts of law and other governmental agencies. The first Chairman of the Council, Ingvar Gullnäs, after a long career in leading positions within the Swedish Ministry of Justice, was both the Attorney General and County Governor. The most recent Chairmen of the Council, Bo Svensson and Johan Munck, as many of you know have been the Chief Justices of the Supreme Court of Sweden. Looking ahead, there is good reason to believe that the current Chief Justice of the Supreme Court, Marianne Lundius, will be the next Chairman of the Council – she has long been the Vice Chairman of the Council.

The Council meets as needed. The Council itself decides whether or not to hear a matter brought before the Council. In this context, consideration is given, among other things, to whether or not the issue is or may be expected to be addressed elsewhere, such as in

courtroom proceedings. In practice, there have been very few cases in which the Council has refused to hear a legitimate petition.

It is hardly surprising that the absolute majority of questions are presented by legal counsel. The combination of what are frequently large transactions in terms of value and challenging issues of interpretation and assessment make it almost a necessity to retain an expert in the area in order to adequately formulate a petition to the Council.

The Council's matters are almost exclusively handled in writing. There have been very few occasions on which a petition was supplemented by oral proceedings before the Council.

The Council is quorate when attended by at least four and not more than eight members. The composition is determined by the secretariat of the Council based on, among other things, the relevant issue. A clear ambition of the Secretariat is to have as many members as possible in attendance, not the least in order to establish a broad foundation for the Council's position. In recent years, an average of seven members have participated in the meetings of the Council.

Deliberations by the Council are based on the petition. The Secretariat frequently drafts a proposed statement, but this is not initially presented to the Council. Rather, the discussion is open. Experience has shown that there are nearly always substantially more facets and aspects to the issue than those foreseen by the Secretariat and sometimes perhaps also the petitioner.

In practice, the decisions by the Council are unanimous. According to the by-laws of the Council, it is possible to reach majority decisions but this has only occurred on one occasion to date, more than twentyfive years ago. Clearly, the aspiration to achieve unanimity may produce formulations which may be regarded by some as far too compromising and yet, for my part, I believe that the alternative – i.e. majority decisions with dissenting opinions – would wholly undermine the position of the Council. In order for the statements by the Council to be respected as an expression of best practices in the stock market, the decisions taken by the Council must be unanimous.

Statements from the Council as a general rule cannot be appealed. However, there is an important exception to this rule. Like other decisions of governmental authorities, decisions taken by delegation from the Financial Supervisory Authority are appealable. The latter primarily involve decisions concerning mandatory bids. Over the last ten years during which this possibility for appeal has existed, only four decisions have been appealed, in all cases without success.

The Council's ambitions are to be readily accessible and have short response times. The first ambition means that it is normally possible to reach the Secretariat and where necessary refer a matter on any day of the week, 365 days a year, and largely also at any time of day. A glance at the journal reveals that a not insignificant number of matters are initiated during the weekend or on holidays.

The response time for a particular matter depends of course on the nature of the matter. Statistics show that matters decided by the Chairman result, as a rule, in a decision (statement) by the Council on

the day after the final petition was submitted, sometimes even on the same day. Cases decided by the Council as a whole also have short response times which do not, as a rule, exceed one week. Matters requiring longer response times typically involve multiple parties such as, for example, competing bidders, who must be given the opportunity to comment on each other's submissions.

The Secretariat is sometimes accused of spoiling the business community by providing an exceedingly high level of service. Perhaps there is something to this, but it is essentially the result of what can be achieved through efficiently organised operations within the context of self-regulation.

## Sanctions

From the outset, Council statements have been met with great respect. When the Council established that a certain planned measure was not compatible with best practices, the finding was respected and, when the Council criticised a measure which had already been pursued, that criticism was taken with the utmost seriousness by all parties involved notwithstanding that the Council had no formal sanctions at its disposal.

Today, the situation is more complex. The regulatory regime in certain respects has changed and the market climate is tougher. It is still the case that if the Council makes a statement that certain planned measures are not compatible with best practices, it is respected. Yet, I have the feeling that nowadays - if you'll pardon the expression - we must occasionally spell it out in capital letters. We have noted sometimes how some actors, not the least foreign, on the Sweden market focus

more on the letter rather than the spirit of the rules and Council statements, and they attempt to find various ways to circumvent the rules and statements. It is also striking to see how much pressure is sometimes put on financial and legal advisors – sometimes contrary to their own sense of what are best practices on the stock market – to strive to serve the interests of their principal.

As regards statements from the Council concerning measures which have already been carried out, it remains the case that the Council itself has no sanctions at its disposal. However, the exchanges can now take disciplinary measures against all listed companies violating generally accepted practices in the securities market. In practice, this means that if the Council establishes that a listed company acted in violation of best practices, it is highly probable that the company will be subjected to disciplinary sanctions by the market place.

In addition, the takeover area has its own, developed system of sanctions. If the Council finds that an offeror has acted in violation of the takeover rules, it may result in disciplinary sanctions. The same applies to actions by the target company.

## Conclusion

Anyone who is interested in ethics on the financial market can find an interesting example in the activities of the Swedish Securities Council of what may be achieved if all parties are prepared to assume their responsibilities. As you know, there is no enterprise which is so good that it cannot be improved, but I dare assert that the Council, in its 30 years

of operation, has contributed significantly to relatively sound ethics on the Sweden stock market in general and in the area of takeovers in particular. With the continued readiness of listed companies, institutional owners and, not the least, the financial and legal advisors to safeguard the Council's mission, there is good reason to believe that this trend will continue.

In a broader perspective, I am willing to state that self-regulation on the Sweden stock market is one of the explanations why, notwithstanding fervent takeover activity for several decades, we have hardly had a single case in a court of law concerning takeovers. Last but not least, I believe that self-regulation to a large extent has made it possible to avoid the poorly thought-out and draconian legislation which history has shown to otherwise be the result of scandals and crises of confidence in the business community and on the stock market.

Thank you for your attention.