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Newsletter

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CORPORATE LAW

The Implementation of the Minder Initiative: Ordinance Against Excessive Compensation in Listed Joint Stock Companies

On 20 November 2013, the Federal Council issued the ordinance against excessive compensation in listed joint stock companies (Ordinance). The Ordinance obliges listed Swiss joint stock companies to annually submit the top management's compensation to shareholders for a binding vote. The Ordinance also contains far-reaching new rules on the corporate governance of Swiss public companies with direct effects on executive management, shareholders, pension funds and independent proxies. Some of the provisions are already to be complied with as of the entry into force of the ordinance on 1 January 2014.

1 BACKGROUND

On 3 March 2013, Swiss voters voted in favour of the popular initiative "against excessive pay", frequently named the Minder Initiative after its initiator, the council of states member Thomas Minder. A new art. 95 para. 3 was added to the Swiss Federal Constitution as a result. This constitutional provision sets forth a number of principles for listed Swiss joint stock companies which together are aimed at increasing the shareholders' rights to have a say in the remuneration of the members of the board of directors and executive management (say on pay). The new con-

stitutional provision is not self-executing, i.e. it requires further enactment at legislative level. The Minder Initiative, however, expressly provides for a transitional implementation within a period of one year by a federal ordinance. The Federal Council has now met this requirement by issuance of the Ordinance. In contrast to the draft ordinance presented in June 2013, the final version contains a number of significant changes. The ordinance will enter into effect on 1 January 2014 and will be valid until the implementing legislation is enacted. It will likely have significant prejudicial effects on the forthcoming legislation.

2 SCOPE

The Ordinance is applicable only to joint stock companies governed by the Swiss code of obligations, whose shares are listed on a stock exchange in Switzerland or abroad. It thus in particular does not apply to companies that only have bonds or participation certificates listed. For purposes of the Ordinance, a stock exchange is defined as a publicly regulated and recognized securities trading entity within the meaning of Swiss stock exchange law.

"As of now, the shareholders' meeting will on an annual basis elect all members of the board of directors, the chairman as well as the members of the compensation committee."

3 NEW CORPORATE GOVERNANCE RULES

3.1 ELECTION OF THE BOARD OF DIRECTORS AND ITS CHAIRMAN

For members of the board of directors of listed Swiss stock companies the term of office is as of now uniformly one year. Therefore, all board members must stand for re-election already at the ordinary shareholders' meeting 2014, even if they were originally elected for a longer term. Starting with the ordinary shareholders' meeting 2014, the shareholders will also annually elect the chairman of the board of directors, a vote which so far was predominantly incumbent on the board of directors itself.

3.2 COMPENSATION COMMITTEE

The Ordinance requires listed Swiss stock companies to establish a compensation committee. A similar form of board committee already exists in many listed Swiss companies, e.g. the compensation committee in accordance with the Swiss Code of Best Practice for Corporate Governance. However, the members of the compensation committee may no longer be elected by the board of directors, but have to be elected from among the board members by the shareholders' meeting. These elections must already be conducted for the first time at the ordinary shareholders' meeting 2014 as well. The Ordinance does not define the tasks and competence of the compensation committee, but requires that corresponding provisions be adopted in the company's articles of association.

3.3 DELEGATION OF MANAGEMENT

The Ordinance still allows delegation of management, but only to individuals (not legal entities). Thus, the delegation of management functions to a group company is no longer permitted. At least, the Ordinance expressly permits the delegation of asset management to legal entities, which is of significant importance for listed investment companies in particular.

3.4 MANDATORY PROVISIONS IN THE ARTICLES OF ASSOCIATION

In addition to the above mentioned provisions setting out the tasks and competence of the compensation committee as well as the terms and conditions of the vote on compensation (which will be explained hereafter), the company's articles of association must from now on also make provision for the following:

- > the number of permissible activities of the members of the board of directors, the executive management and members of the advisory board on administrative boards or executive bodies outside their own group of companies; and
- > the maximum term and the maximum notice period for agreements with members of the board of directors and the executive management, which are relevant for compensation. Notice periods or contract durations exceeding one year are in any event prohibited by law.

3.5 VOTING REPRESENTATION

In listed Swiss joint stock companies voting representation by governing bodies of the company itself and/or custodians is abolished as of 1 January 2014. Already with respect to the ordinary shareholders' meeting 2014, the company may only propose the independent proxy to represent shareholders. The independent proxy must henceforward meet the same independence requirements as the auditors and is elected on a yearly basis by the shareholders' meeting. Where the company does not have an independent proxy elected by the shareholders' meeting, for instance due to a resignation on short notice, the independent proxy may exceptionally be appointed by the board of directors. The Ordinance does not introduce direct remote electronic voting, but obliges companies to ensure that powers of attorney and instructions for the independent proxy may also be given electronically as of the ordinary shareholders' meeting 2015.

"The ordinance grants shareholders a binding vote on compensation, but leaves it to the company to set out the details of the vote in its articles."

4 NEW RULES ON COMPENSATION

4.1 VOTES ON COMPENSATION

The most significant new requirement is the obligation on all listed Swiss joint stock companies to carry out a binding vote on compensation. The shareholders' meeting must annually and separately vote on the aggregate amount of compensation for the members of the board of directors, the executive management and the advisory board. In contrast to some foreign legislation on director pay, the Ordinance does not impose a cap on remuneration.

Companies are required to set out the details of the vote on compensation in their articles of association. Various models are possible: It is for example conceivable to pass a vote on a compensation budget, whereby the shareholders state in advance the maximum amount of compensation for the respective governing bodies for the coming year. Also possible would be a vote on a fixed compensation for the term until the next ordinary shareholders' meeting (prospective vote) and on a performance-based compensation for the closed financial year (retrospective vote). The first vote on compensation must be passed in the ordinary shareholders' meeting 2015.

The articles of association may also make provision for the course of action to be taken in case of a negative shareholder vote on the compensation. The explanatory report

issued by the Federal Council however states that the course of action must not constrain the decision-making power of the shareholders' meeting. According to such explanatory report, rules in the articles of association providing that, if the compensation is rejected, the last approved compensation remains valid or the determination of compensation is to be delegated to the compensation committee shall be "clearly impermissible".

4.2 COMPENSATION REPORT

The disclosure of the compensation paid during the financial year starting on or after 1 January 2014 is no longer made in the annex to the annual financial statements, but in a separate compensation report. Such report must be reviewed by the auditors and disclosed to the shareholders in the same manner as the audit report on the annual financial statements. In terms of its content, the compensation report differs only marginally from the present annex to the annual financial statements.

"Compensation for entitlements that forfeit upon leaving the previous employer is still allowed, whereas advance compensation is not."

4.3 IMPERMISSIBLE COMPENSATION

The Ordinance generally prohibits all compensation to the members of the board of directors, the executive management and the advisory board, taking the form of severance pay provided for by contract or the articles, advance compensation (e.g. advance salary payments) or incentive payments for restructurings within the group. By contrast, new-hire compensation (e.g. for a loss of entitlements with the previous employer), statutory severance pay (e.g. according to employment law), incentive payments for transactions outside the group as well as compensation at fair market value for non-compete clauses of a reasonable duration are still allowed, provided they are approved by the shareholders' meeting. The difficult distinction to be drawn in an individual case between the still allowed and newly impermissible types of compensation is of great significance given the threat of criminal sanctions.

The Ordinance further provides that as of the ordinary shareholders' meeting 2015 various other types of benefits and compensation to the executive bodies referred require a particular basis in the company's articles of association. This applies to the grant of loans, credits and pension benefits outside the occupational pension system, with respect to which an amount must be indicated in the articles. It also applies to performance-related remuneration and participation plans, with respect to which the main principles need to be spelled out in the articles. Even where a basis is provided in the articles of association, actual benefit or compensation payments must always be approved by the shareholders' meeting and disclosed in the compensation report. Articles and regulations must be adapted by the date of the ordinary shareholders' meeting 2015, and employment agreements by the end of 2015.

5 PENSION SCHEMES

Pension schemes falling under the Swiss Law on the Vested Benefits in the Old Age, Survivors' and Invalidity

Benefits Scheme, in Switzerland normally referred to as pension funds, will be subject to a voting and disclosure obligation as of 2015 in respect of the shares held by them in listed Swiss joint stock companies. Shares which are indirectly held by a pension fund are also covered to the extent the pension fund can exercise the right to vote or the shares are held by a fund it controls (e.g. a single-investor fund). A pension fund must exercise its voting right with respect to the following agenda items:

- > election of the members of the board of directors, the chairman of the board, and the members of the compensation committee;
- > votes on compensation pursuant to the Ordinance; and
- > votes on changes to the articles of association of the company in accordance with the Ordinance.

There is no requirement to vote on other agenda items. Pension funds will be entitled to abstain from voting on agenda items that are subject to mandatory voting, if this is consistent with the interests of their beneficiaries. The supreme body in the pension fund has to set out in a regulation until the end of 2014 the principles for determining the interest of the beneficiaries. Last but not least, pension funds must disclose on an annual basis how they voted, individually stating the agenda items in respect of which they voted against the board of directors or abstained from voting.

"Through the enactment of detailed and balanced rules in the Ordinance, the risk of unintentionally being subject to criminal liability is considerably lessened."

6 CRIMINAL PROVISIONS

The Minder Initiative provides rather bluntly that contraventions of the initiative's "principles" are sanctioned by imprisonment of up to three years and a fine of up to the equivalent of six years' annual compensation. The Ordinance implements this provision by providing a detailed and balanced catalogue of offences, rendering them punishable only where they occur "against better knowledge" (direct intent). Only the conscious payment or receipt of impermissible compensation by members of the board of directors, the executive management, or the advisory board is punishable by imprisonment and a fine. Other offences should in practice not lead to imprisonment. Furthermore, those offences can only be committed as main perpetrators by members of the board of directors, as well as members of the supreme body and executive directors of pension funds. In contrast to the draft ordinance, through the enactment of detailed and balanced rules in the final Ordinance, the risk of unintentionally being subject to criminal liability is considerably lessened. Nonetheless, caution should be exercised if actions could trigger criminal charges, particularly in view of the fact that all offences are prosecuted *ex officio*.

7 REQUIRED ACTION

Swiss listed joint stock companies should essentially take the following action:

- > For the upcoming ordinary shareholders' meeting 2014, the necessary election nominations (e.g. compensation committee, independent proxy) must be made and previously used documentation must be adjusted to the new requirements.
- > The various options for votes on compensation should be examined in due course in order to adopt a voting model tailored to the specific needs of the company.
- > Although an adaption of the articles and regulations to the new requirements is not mandatory until the ordinary shareholders' meeting 2015, a comprehensive revision of the articles of association should already be considered for the ordinary shareholders' meeting 2014.
- > All bonus systems, participation plans and compensation related agreements with board members and top management must be reviewed and timely adjusted to meet the new requirements.

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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. Should you seek advice with regard to your specific circumstances, please contact your Schellenberg Wittmer liaison or any of the following persons:

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