

Update

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Minder initiative – Swiss Government consults on draft say-on-pay ordinance

On 14 June 2013, the Swiss Federal Council (the executive branch of the Swiss federal government) submitted for public consultation a draft ordinance on say-on-pay and excessive executive remuneration. The ordinance will implement the new provisions of the Swiss Federal Constitution resulting from the affirmative vote by the Swiss people and cantons in March 2013 on the so-called "rip-off initiative" (also known as the "Minder initiative", introduced by the politician Thomas Minder). The draft ordinance sets forth a temporary regime which is expected to enter into effect on 1 January 2014 and which prevails over existing Swiss corporate law until the Swiss Parliament translates the Minder initiative into law.

This newsflash summarizes the contents of the draft ordinance and the contemplated transitional regime.

I. The new requirements

1. Scope

The new rules will apply to corporations organized under Swiss law whose shares are listed on a stock exchange in Switzerland or abroad. Foreign companies listed on a Swiss stock exchange or having a tax residence in Switzerland are not affected.

2. Mandatory election by shareholders of:

- **the chairman of the board;**
- **the members of the remuneration committee; and**
- **an independent voting representative of shareholders (independent proxy)**

The Minder initiative requires Swiss companies to depart from the current practice according to which the chairman, the members of the remuneration committee and the independent proxy be appointed by the board.

The draft ordinance clarifies that members of the remuneration committees must nonetheless be members of the board.

Also, the draft ordinance specifies that the independent proxy must satisfy the same (strict) independence requirements as statutory auditors. The independent proxy must abstain from voting in the absence of specific instructions. However, the explanatory report of the Federal Office of Justice (FOJ) clarifies that the granting of general instructions (e.g. "vote in favour of the board's proposals") remains possible, including with respect to "ad hoc" proposals submitted at a shareholders' meeting without having been mentioned in the proxy materials.

3. Individual elections; mandatory one-year terms

The draft ordinance requires that board members (including the chairman) be individually elected for one-year terms ending on the first annual general meeting (AGM) following their election. Shareholders may appoint a replacement for the chairman.

4. Annual binding shareholder vote on the aggregate remuneration of the members of the board, executive committee (*Geschäftsleitung/direction*) and any advisory committee (*Beirat/conseil consultatif*)

As the ordinance does not cap remuneration, the say-on-pay rule is the backbone of the new regime. The draft ordinance requires separate votes for the aggregate remuneration of each of the board, the executive committee and the advisory committee. Approval of individual remuneration packages is not required (although the individual remuneration of each member of the board and advisory committee must be disclosed in the compensation report – see 7 below).

Remuneration must, in each case, be split between "fixed" and "variable" elements. Fixed remuneration must be approved prospectively for the period to the next AGM. Variable remuneration must be approved retrospectively for the past business year. As a result, the board must submit six separate remuneration proposals to the shareholders at each AGM. The distinction between "fixed" and "variable" remuneration remains relatively unclear in the draft ordinance. Distinguishing between the two without incurring the risk of infringing the new rules (and their criminal provisions – see 12 below) will be one of the major challenges of Swiss listed companies under the new regime.

In case of a rejection of the board's remuneration proposals, the board can submit a new proposal at the same meeting. If the new proposal is also rejected, another shareholders' meeting must be convened within three months.

The articles of incorporation can provide for a "reserve" for additional payments to compensate members of the executive committee who are appointed after the relevant shareholders' vote.

Companies may also deviate from the regime referred to above and instead provide for their own say-on-pay rules in their articles of incorporation. However, any alternative regime must satisfy certain minimum requirements (in particular an annual, separate and binding shareholders' vote on the aggregate remuneration of each of the board, the executive committee and the advisory committee). Significant easing of the statutory regime is consequently not possible.

5. Prohibition of certain forms of remuneration, i.e.

- severance payments;
- advance remuneration payments;
- payments related to the acquisition or disposal of businesses;
- loans, credits, pension benefits or performance related remuneration not provided for in the articles of incorporation; and
- allocation of shares, other equity securities and conversion rights or options not provided for in the articles of incorporation

The draft ordinance clarifies that the prohibition applies only to the members of the board, executive committee and advisory committee, which was unclear in the Minder initiative.

Also, the report of the FOJ clarifies that:

- the ban on severance payments does not prohibit bona fide compensation for non-compete covenants;
- the prohibition of advance remuneration does not exclude sign-on bonuses; and
- the prohibition of M&A-related remuneration does not exclude that an M&A transaction be taken into consideration to assess the performance of a particular executive.

6. The articles of incorporation must contain provisions on the following:

- the number of outside mandates of directors and officers;
- the duration of the employment agreements of the members of the executive committee;
- the tasks and competences of the remuneration committee;
- the amount of any loans, credits and retirement benefits of members of the board, executive committee and advisory committee;
- the principles applicable to performance-linked remuneration of the members of the board, executive committee and advisory committee;
- the principles for the allocation of shares, options and other equity-linked compensation to members of the board, executive committee and advisory committee;

- **any authorization of the board to delegate management powers to individual board members or other individuals;**
- **any supplement amount to cover fixed compensation of new hires at executive committee's level after the shareholders' say-on-pay vote (see 4 above); and**
- **any provisions deviating from the prescribed say-on-pay rules (see 4 above).**

According to the FOJ's report, the articles of incorporation do not need to contain detailed provisions on equity-linked compensation programmes, but only their "main principles and terms".

7. Compensation report

The board has to prepare, publish and submit to shareholders an annual compensation report. The information required corresponds essentially to what Swiss listed companies are currently required to mention in the notes to their financial statements. As from 2014, the information will have to be included in a separate report, which will have to be audited in the same manner as the company's financial statements.

Under the draft ordinance, the compensation report only includes information about past remuneration. It is not required to include information about the company's remuneration policies and processes. Disclosure of such matters will continue to be governed by the listing rules of the relevant stock exchange (e.g. the directive on corporate governance of the SIX Swiss Exchange).

8. Prohibition of corporate and custodian proxies

Under the new regime, shareholders have the choice to attend a shareholders' meeting in person, to appoint a proxy of their choice, or to instruct the independent proxy appointed by the shareholders (see 2 above). The Company itself will no longer be allowed to receive proxies from shareholders. Also, custodians will only be allowed to exercise voting rights on behalf of their clients if they are specifically authorized and instructed to do so.

9. Prohibition of delegation of management responsibilities to a body corporate

The draft ordinance confirms the requirement of the Minder

initiative that management tasks may be delegated only to individuals and not to group companies or other entities. This new requirement is likely to impact mostly investment companies, which typically delegate management functions to external managers.

10. Electronic voting

The draft ordinance requires that shareholders be given the possibility to vote electronically by giving proxies and voting instructions to the independent proxy. The draft ordinance does not, however, require companies to ensure real-time "direct" electronic voting from remote locations.

11. Swiss pension funds must exercise voting rights in the interest of the persons insured and disclose their votes

The draft ordinance requires that Swiss pension funds specify their voting policies in written regulations. A decision not to exercise voting rights or to abstain from voting on any particular topic must be justified by the interest of the persons insured.

Pension funds must disclose how the voting rights are being exercised at least once a year in a report; information on each particular vote is not expected but the report can be in summary form.

12. Criminal liability

Intentional breach of the rules of the ordinance by members of the board, executive committee or advisory committee can be punished by imprisonment of up to three years and a fine not exceeding six times the applicable annual remuneration. Persons other than the members of the board, the management and any advisory board may be criminally liable for inducing or assisting in an infringement.

Members of the (highest) executive bodies of pension funds and individuals entrusted with the management of pension funds who deliberately violate the duty to exercise voting rights or to disclose their votes (see 11 above) are criminally liable for a fine of up to CHF 540,000.

II. Transitional regime

Under the draft ordinance, the new rules will apply as from 1 January 2014, subject to certain transitional periods

contemplated therein. In particular:

- the prohibition of certain forms of remuneration (see I.5 above); existing employment arrangements must be amended by 31 December 2014;
- the prohibition of corporate and custodian proxies (see I.8 above);
- the prohibition of delegation of management responsibilities to body corporates (see I.9 above); and
- the corresponding criminal provisions

will apply **as from 1 January 2014**.

At the first AGM following entry into force of the new rules (*i.e.* at the **2014 AGM**):

- the rules regarding the individual elections by shareholders of the members of the board, the chairman and the members of the remuneration committee for one-year terms (see I.3 above) will apply for the first time;
- a compensation report (see I.7 above) will need to be produced for the first time; and

- shareholders will have to appoint the independent proxy (see I.2) for the 2015 AGM.

On the occasion of the second AGM following entry into force of the new rules (*i.e.* at the **2015 AGM**):

- shareholders will have to approve for the first time with a binding vote (i) the "variable" remuneration of the members of the board, executive committee and advisory committee accrued during the 2014 business year and (ii) the "fixed" remuneration applicable until the following AGM; and
- systems allowing shareholders to give electronic instructions to the independent proxy will have to be available.

Swiss pension funds must exercise voting rights in the interest of the persons insured and disclose their votes as from **1 January 2015**.

In addition, Swiss listed companies must adapt their articles of association and bylaws to the new regime by **31 December 2015**.

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