

Update

Newsflash November 2013

Minder initiative – Swiss Government adopts ordinance against excessive remuneration

On 20 November 2013, the Swiss Federal Council (the executive branch of the Swiss federal government) adopted the final ordinance against excessive remuneration by listed companies. The ordinance implements the provisions of the Swiss Federal Constitution resulting from the affirmative vote by the Swiss people on 3 March 2013 on the so-called "rip-off initiative" (also known as "Minder initiative", introduced by the politician Thomas Minder). The ordinance will enter into force on 1 January 2014 and will apply until the Swiss Parliament translates the Minder initiative into law.

This newsflash highlights the material changes to the earlier draft ordinance and summarizes the essential points of the ordinance, including the transitional regime.

I. Major changes and clarifications

1. More flexible say-on-pay voting

The ordinance gives companies significant flexibility on how to implement the required shareholder vote on the remuneration of the members of the board and the executive committee. Whereas the draft ordinance of 14 June 2013 provided for "default rules" for the shareholder votes, but also allowed statutory deviations within certain limits, the definitive ordinance merely sets out mandatory minimum requirements for the votes on remuneration. Within this mandatory framework, companies are now required to adopt their own specific rules in their articles of incorporation. The respective articles of incorporation must determine, in particular, (1) whether the general meeting is granted mere approval power or whether shareholder proposals with respect to remuneration matters are permissible, (2) the reference periods for which the remuneration amounts will be approved and (3) the consequences of a rejection of the remuneration proposals by the board (see section II.4 below). A distinction between fixed and variable remuneration is no longer made.

2. Maximum term and notice period for employment agreements of one year

The ordinance limits the maximum term and notice periods (which must be set out in the articles of incorporation) for employment agreements of the members of the board and the executive committee to one year.

3. Sign-on bonuses are permitted

The ordinance confirms that sign-on bonuses continue to be permitted. Such bonuses qualify as remuneration and must, therefore, be included in the compensation report.

4. Restricted scope of criminal provisions

Certain criminal offences contemplated by the draft ordinance have been deleted and the severe criminal sanctions provided by the draft ordinance have been partially mitigated (see section II.12 below). Criminal sanctions require that the offender must have acted against "better knowledge". Also, the payment or receipt of remuneration that is not or not yet approved by the shareholders' meeting does not constitute a criminal offence (but may lead to civil liability). Further, a violation of the maximum number of external mandates (which must be

set out in the articles of incorporation) by a member of the board or the executive committee does not lead to criminal sanctions.

5. Transitional regime

The articles of incorporation and regulations must be adapted to the rules of the ordinance at the latest by the second annual general meeting (AGM) after the entry into effect of the ordinance (i.e. by the 2015 AGM). (The draft ordinance had provided for a two-year transitional period). Employment agreements must be amended to comply with the requirements of the ordinance by the end of 2015. (The draft ordinance had provided for only one year). The compensation report is to be prepared for the first time for the financial year 2014.

II. Key points of the ordinance

1. Scope

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

2. Mandatory election by shareholders of:

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

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

Also, the ordinance specifies that the independent proxy must satisfy the same (strict) independence rules as the statutory auditors. In the absence of instructions, the independent proxy must abstain from voting (with the consequence that such abstention has the effect of a no-vote unless provided otherwise in the articles of incorporation). General voting instructions with respect to proposals which have not been announced before and new agenda items (e.g. a general instruction to vote for the board's proposals) remain possible. However, proxies and

instructions may only be granted for the following AGM. If the position of the independent proxy becomes vacant, the board may appoint an independent proxy for the following AGM.

3. Individual elections; mandatory one-year terms

The chairman and the members of the board and the members of the remuneration committee must be elected annually and individually. The term of office ends at the closing of the next AGM. In contrast to the draft ordinance, only the chairman of the board (and not a deputy chairman) must be elected by the shareholders' meeting. If the position of the board's chairman becomes vacant, the new chairman of the board will be appointed by the board for the remainder of the term unless provided otherwise in the articles of incorporation.

4. Annual binding shareholder vote on the aggregate remuneration of the board and the executive committee

The vote on the aggregate remuneration by the general meeting is the backbone of the new regime. As already outlined in section I.1 above, the ordinance does not provide for a specific model with respect to votes on remuneration of the board and the executive committee, but requires companies to provide for their own rules in the articles of incorporation. The companies are granted flexibility to design their rules, provided that the following minimum requirements are complied with:

- > the votes on the remuneration must take place annually;
- > there must be separate votes on the aggregate remuneration of the board of directors and the executive committee (but individual approval of remuneration packages is not required); and
- > the vote has a binding (and not just consultative) effect.

The companies may, in particular, choose whether they want to vote on remunerations (i) prospectively for a one-year period (e.g. for the current or the next business year), (ii) retrospectively for the last business year, or (iii) a combination of these two options (e.g. prospectively for the base salary and retrospectively for performance based remuneration). Additionally, it is at the companies' discretion whether to provide for a mere shareholder approval (i.e. without the right of shareholders to submit own proposals) or as true decision power (where shareholders may submit differing proposals).

Also, the procedure in case of a rejection of the board proposals can be determined in the articles of incorporation (e.g. that an extraordinary shareholders' meeting be convened to vote on new remuneration proposals). However, it would be impermissible to simply provide that in such a scenario the last approved aggregate remuneration would continue to apply or that the remuneration is determined by the board of directors.

If the remuneration of the executive committee is approved prospectively, the articles of incorporation may provide for a certain "reserve" for additional payments to compensate members of the executive committee who are appointed after the respective AGM. However, the reserve may be used only after the approved maximum remuneration amount has been exhausted.

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

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

These prohibitions apply only to the members of the board and the executive committee. If such forms of remuneration are provided in currently existing employment agreements, they can in our view be claimed (and paid) until the end of the two-year transitional period (or until the respective employment agreement is amended, if earlier).

The ban on *severance payments* prohibits all payments and benefits triggered by a termination of an employment agreement. It does not prevent, however, the payment of bona fide compensation for non-compete covenants or consulting services, contractually agreed payments up to an agreed termination period not exceeding one year, and settlement of holiday and overtime claims.

The prohibition of *advance payments* does not exclude sign-on bonuses or the compensation of lost benefits (e.g.

forfeited options from a former employer) or costs incurred (e.g. relocation costs) due to the change of job.

The ban on *M&A-related remuneration* prohibits transaction bonuses for mergers, acquisitions and disposals.

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

- > **the maximum number of permissible external mandates (in the boards of other companies) of the members of the board and the executive committee;**
- > **the details of the shareholder vote on the aggregate remuneration and, as the case may be, the further procedure in case of a rejection of the board proposals;**
- > **the maximum term and termination period for employment agreements of the members of the board and the executive committee (which may not exceed one year);**
- > **the principles of the duties and competences of the remuneration committee;**
- > **the amount of any loans, credits and retirement benefits of members of the board and the executive committee;**
- > **the principles applicable to performance based remuneration of the members of the board and the executive committee;**
- > **the principles for allocation of shares, options and other equity-linked compensation to members of the board and the executive committee;**
- > **the authorization of the board to delegate management powers (see para. 9 below);**
- > **any reserve amount to cover compensations of new hires at the executive committee's level after the shareholders' say-on-pay vote (see para. 4 above); and**
- > **the remuneration of members of the board and the executive committee for work for other group companies.**

In contrast to the draft ordinance, only the principles of the duties and competences of the remuneration committee need to be laid down in the articles of incorporation. Also, only the principles for performance based remuneration and share and option employee participation schemes must be provided and the details can be left to the plan

documentation, so that amendments of the plans do not require changes of the articles of incorporation as long as they do not go beyond these principles.

7. Compensation report

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

Under the ordinance, the compensation report only includes information about past remuneration. It is not necessary 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 the shareholders' meeting in person, appoint a proxy of their choice, or give proxy or instruct the independent proxy. Corporate and custodian proxies are no longer permissible.

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

The ordinance confirms the requirement of the Minder initiative that management powers may be delegated only to individuals and not to group companies or other entities. However, an exception exists for the delegation of asset management functions which may be delegated to group companies or unrelated companies. This exception is important for investment companies.

10. Electronic proxies and voting instructions

The board of directors must ensure that at the latest on the 2015 AGM the shareholders may give electronic proxies and voting instructions to the independent proxy. There is, however, no duty to provide for real-time "direct" electronic voting.

11. Swiss pension funds must exercise voting rights and disclose their votes

Swiss pension funds are required to exercise their voting rights in the interest of the insured on the following subject matters:

- > the approval of the remuneration of the board of directors and the executive committee;
- > the election of the chairman and the members of the board of directors as well as the members of the remuneration committee and the independent proxy; and
- > the relevant provisions of the articles of incorporation contemplated by the ordinance (see para. 6 above).

The duty to vote applies only to these subject matters and not generally. In contrast to the draft ordinance pension funds may not choose not to represent their shares at all in a shareholders' meeting for the indicated subject matters.

Pension funds must disclose at least once a year in a report how they have exercised their voting rights. A summary of the exercise of the voting rights is sufficient; a more detailed disclosure is required only in cases where the pension fund rejected the board proposals or abstained from voting.

12. Criminal liability

Compared to the draft ordinance the scope of the criminal provisions has been reduced to specific core infringements. Members of the board and the executive committee who pay or receive severance payments, advance remuneration payments or M&A transaction bonuses "against better knowledge" can be punished by imprisonment of up to three years and a fine not exceeding six times the applicable annual remuneration. The supplemental report to the ordinance clarifies that a member acts "against better knowledge" only if he or she has certainty about the inadmissibility of the relevant compensation.

Further criminal sanctions are provided for certain infringements of the ordinance by board members.

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

III. Transitional regime

The new rules will apply **as from 1 January 2014**, subject to certain transitional periods. In particular the following rules are applicable as from that date on:

- > the prohibition of certain forms of remuneration (see section II.5 above); existing employment arrangements must be amended by 31 December 2015;
- > the prohibition of corporate and custodian proxies (see section II.8 above);
- > the delegation of management responsibilities (see section II.9 above); and
- > the corresponding criminal provisions.

Already 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 section II.2 and 3 above) will apply for the first time; and
- > shareholders will have to appoint the independent proxy for a one-year term (see section II.2 above).

At the latest at the second AGM following the 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 the remuneration of the members of the board and the executive committee;
- > the articles of incorporation and the organizational regulations must be adapted to the new rules of the ordinance;
- > a compensation report (see section II.7 above) must be prepared and audited for the first time; and
- > systems allowing shareholders to give electronic proxies and voting instructions to the independent proxy must be available.

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

Please do not hesitate to contact us in case of any questions.

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