The Executive Remuneration Review

Seventh Edition

Editors
Arthur Kohn and Janet Cooper

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THE EXECUTIVE REMUNERATION REVIEW

SEVENTH EDITION

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CONTENTS

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EDITOR'S PREFACE

Executive remuneration encompasses a diverse range of practices and is consequently influenced by many different areas of the law, including tax, employment, securities and other aspects of corporate law. We have structured this book with the intention of providing readers with an overview of these areas of law as they relate to the field of executive remuneration. The intended readership of this book includes both in-house and outside counsel who are involved in either the structuring of employment and compensation arrangements, or more general corporate governance matters. We hope this book will be particularly useful in circumstances where a corporation is considering establishing a presence in a new jurisdiction and is seeking to understand the various rules and regulations that may govern executive employment (or the corporate governance rules relating thereto) with regard to newly hired (or transferring) executives in that jurisdiction.

The most fundamental considerations relating to executive remuneration are often tax-related. Executives will often request that compensation arrangements be structured in a manner that is most tax-efficient for them, and employers will frequently attempt to accommodate these requests. In order to do so, of course, it is critical that employers understand the tax rules that apply in a particular situation. To that end, this book attempts to highlight differences in taxation (both in terms of the taxes owed by employees, as well as the taxes owed – or tax deductions taken – by employers), which can be the result of:

a the nationality or residency status of the executives;

b the jurisdiction in which the executives render their services;

c the form in which executives are paid (e.g., cash, equity (whether vested or unvested) or equity-based awards);

d the time at which the executives are paid, particularly if they are not paid until after they have 'earned' the remuneration; and

e the mechanisms by which executives are paid (e.g., outright payment, through funding of trusts or other similar vehicles or through personal services corporations).

In addition to matters relating to the taxation of executive remuneration, employment law frequently plays a critical role in governing executives' employment relationships with their employers. There are a number of key employment law-related aspects that employers should consider in this context, including:

a the legal enforceability of restrictive covenants;

b the legal parameters relating to wrongful termination, constructive dismissal or other similar concepts affecting an employee's entitlement to severance on termination of employment;

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c any special employment laws that apply in connection with a change in control or other type of corporate transaction (e.g., an executive's entitlement to severance or the mechanism by which an executive's employment may transfer to a corporate acquirer); and

d other labour-related laws (such as laws related to unions or works councils) that may affect the employment relationship in a particular jurisdiction.

The contours of these types of employment laws tend to be highly jurisdiction-specific and therefore it is particularly important that corporations have a good understanding of these issues before entering into any employment relationships with executives in any particular country.

Beyond tax and employment-related laws, there are a number of other legal considerations that corporations should take into account when structuring employment and executive remuneration arrangements. Frequently, these additional considerations will relate to the tax or employment law issues already mentioned, but it is important they are still borne in mind. For example, when equity compensation is used, many jurisdictions require that the equity awards be registered (or qualify for certain registration exemptions) under applicable securities laws. These rules tend to apply regardless of whether a company is publicly or privately held. In addition to registration requirements, it is critical for both employers and employees to understand any legal requirements that apply in respect of executives' holding, selling or buying equity in their employers.

Given the heightened focus in many jurisdictions on executive remuneration practices in recent decades – both in terms of public policy and public perception – the application of corporate governance principles to executive compensation decisions is crucial to many companies. Decisions about conforming to best practices in the field of executive remuneration may have substantial economic consequences for companies and their shareholders and executives. Corporate governance rules principally fall into two categories. The first concerns the approvals required for compensatory arrangements; a particular remuneration arrangement may require the approval of the company's board of directors (or a committee thereof). Many jurisdictions have adopted either mandatory or advisory 'say on pay' regimes, in which shareholders are asked for their view on executive remuneration. The second concerns the public disclosure requirements applicable to executive remuneration arrangements; companies should be aware of any disclosure requirements that may become applicable as a result of establishing a new business within a particular jurisdiction, and in fact may wish to structure new remuneration arrangements with these disclosure regimes in mind. In recent years, there has also been increased legislative and shareholder focus in many jurisdictions on environmental and social governance issues, such as the gender pay gap, tying executive compensation to environmental and social goals, and diversity initiatives.

We hope that readers find the following discussion of the various tax, statutory, regulatory and supervisory rules and authorities instructive.

Arthur Kohn
Cleary Gottlieb Steen & Hamilton LLP
New York
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Chapter 20

SWITZERLAND

Matthias Oertle, Franziska Stadtherr-Glättli and Patrick Schärli[1]

I INTRODUCTION

The remuneration of executives, especially of Swiss public companies, has become a subject of public debate since the financial crisis of 2007. While in the past the salaries of executives were considered to be part of the private domain, the view has shifted since the publishing of the figures of the remuneration and bonuses of bank executives who held key positions in banks that had to be bailed out by the taxpayer. In the wake of the public discussion, an initiative was launched and accepted by the Swiss voters in March 2013. As a result, the Swiss Federal Constitution was amended, and stricter rules were introduced for the remuneration of directors and managers of public companies in Switzerland. The idea behind the initiative was to expand the mandatory powers of the shareholders' meeting to the composition and the compensation of the board of directors and the management ('say-on-pay' legislation). The regulations that implement the stricter rules since 1 January 2014 provide for a temporary regime that will remain in place until Parliament has enacted the relevant law.

No specific statutory limitations on the compensation of executives have been introduced. However, the aggregate remuneration of the board of directors, the executive management board and any advisory board has to be approved separately by the shareholders' meeting. Pursuant to the existing regulations, the fixed remuneration may be approved, either prospectively for the period until the next annual general meeting of shareholders, or retrospectively for the preceding business year. Since inception of the regulations in 2014, certain standards have been developed by publicly listed companies in terms of compensation of board and management members. However, the exact degree of flexibility still remains unclear, and there is a risk of civil liability and criminal sanctions because of a violation of the rules. With regard to executives in private companies, no special disclosure or other rules apply.

II TAXATION

i Income tax for employees

Swiss tax resident executives are subject to unlimited taxation in Switzerland. All income from employment (whether paid in cash or in kind) is basically subject to ordinary income taxation in the year of realisation. Income taxes are levied on a progressive scale and the applicable tax rates depend on three factors: the executive's overall annual income (including other

1 Matthias Oertle is a partner, Franziska Stadtherr-Glättli is a counsel and Patrick Schärli is an associate at Lenz & Staehelin.

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personal income such as investment income, income from real estate, etc.), the executive's tax residence (canton and municipality) and the executive's marital status.[2] Capital gains realised on privately held assets are, however, exempt from income taxation (with the exception of Swiss real estate gain).

For Swiss nationals, foreign nationals with a permanent residence permit or married to either a Swiss national or a foreigner holding a permanent residence permit, income taxes are levied on a self-assessment system (i.e., any tax payments are made by the executive). For all other foreign national executives, income taxes are withheld at source by the Swiss employer. Even if subject to taxation at source, executives are required to file an annual tax return and are subject to retroactive ordinary taxation.[3]

Non-resident executives performing services in Switzerland may become subject to limited taxation in Switzerland with respect to their remuneration earned for such services. Tax treaty rules may override the domestic tax rules and result in an exemption from Swiss income tax.[4]

ii Taxation of employee incentive plans

Employee stock options are basically subject to taxation upon exercise. For options taxed upon exercise, the entire capital gain realised upon exercise will be subject to ordinary income taxation. An exception applies for listed options not subject to forfeiture, which will be taxed upon grant. For options taxed upon grant, the listed option price will be the relevant tax base.

Employee shares are taxed upon grant or, if subject to forfeiture, upon delivery. The fair market value of an employee share,[5] minus the purchase price to be paid for by the employee, if any, qualifies as taxable income from employment. A tax discount of approximately 6 per cent per annum[6] is available for restricted employee shares (fractions of a calendar year are also taken into account when calculating the tax discount).[7] An early release of the restriction period leads to additional taxable income. If employee shares are sold back to the employer for less than fair market value in the event of termination of the employment, the executive may apply for a tax deduction in the amount of the loss realised.

Any capital gain realised upon the subsequent sale of the shares is generally a tax-free capital gain, unless the employee qualifies as a professional securities dealer for income tax purposes because of substantial debt financing. However, if the taxable basis of the share upon grant (or exercise, in case of options) was determined based on a recognised valuation method (instead of fair market value), such valuation method will basically again be applied upon sale, and any difference between the sales price and the recognised valuation will be qualified as taxable employment income.[8]

2 Maximum income tax rates vary significantly within Switzerland: from 22.5 per cent in the canton of Zug up to 46 per cent in the canton of Geneva.

3 Provided that the total income from employment exceeds 120,000 Swiss francs per annum (500,000 Swiss francs per annum in Geneva).

4 Such as the 183-day rule. See also Section III.i regarding internationally mobile executives.

5 In case of unlisted shares, the fair market value is determined either based on recent third-party transactions or based on a recognised valuation method as agreed upon with the competent tax administration.

6 Calculation formula: 100/(1.06)n.

7 For example, an employee share subject to a five-year restriction period benefits from a tax discount of 25.274 per cent for income tax purposes.

8 Cantonal tax practice varies in this respect.

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Restricted stock units (RSUs) and share awards are subject to taxation upon vesting. Other than that, the same rules apply as for employee shares.

Any other type of share-related compensation schemes, such as phantom shares or stock appreciation rights (SARs), as well as any deferred cash incentives (subject to adjustments or forfeiture), and profits interests are subject to ordinary income taxation upon payment.

iii Social taxes for employees

Any income from employment is subject to the following Swiss social security contributions (current rates for 2018), which are shared equally between employer and employee:

a 10.25 per cent for old-age insurance, invalidity insurance and loss of income fund (there is no cap);

b 2.2 per cent for unemployment insurance payable for remuneration up to 148,200 Swiss francs; and

c 1 per cent ALV (unemployment insurance) solidarity surcharge on the annual remuneration above 148,200 Swiss francs (no cap).

The executive's share of social security contributions must be withheld by the employer from the executive's salary and must be borne by the executive. The employer's share of social security contributions must, by mandatory Swiss law, be borne by the employer and cannot be shifted to the employee.

With respect to employee shares and options, the income relevant for tax purposes is the relevant basis for social security purposes (which means that any tax discount for restricted employee shares is taken into account for social security purposes).

In addition, pension fund contributions are payable on the remuneration paid to executives, subject to certain limitations. Occupational benefit plans are mandatory for employees with annual salaries between currently 21,150 Swiss francs and 84,600 Swiss francs.[9] In addition to the minimum legal coverage, many occupational benefit funds offer improved benefit plans for management that insure additional parts of the executive's salary, subject to a cap of 842,400 Swiss francs. Contribution rates depend on the age of the executive. Typically, contributions are shared between employer and executive, but improved benefit plans for management often provide for exclusive contributions by the employer.

Income resulting from employee options, shares and other incentive plans is normally not insured under a pension scheme.

iv Tax deductibility for employers

The company's profit as reported in its financial statements prepared based on Swiss accounting principles is relevant for tax purposes. Corrections may be made only if the remuneration of an executive, who is also a shareholder, is considered to be excessive. While cash payments are generally fully tax-deductible, payments in the form of equity awards are tax-deductible only to the extent the company reported an expense in its books, which may vary depending on how the shares are made available to the executive.[10]

9 Contribution limit as of 1 January 2018.

10 While a (re)purchase of own shares or intra-group cost recharge usually leads to a business expense and, therefore, a tax deduction, this is not necessarily the case if shares are newly issued by way of conditional share capital.

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Any employer social security contributions due on executive remuneration are fully tax-deductible.

v Other special rules

One-off severance payments may (in whole or in part) be subject to preferential income taxation if the executive is older than 55 years; gives up his or her professional activity completely; and is faced with a pension fund contribution gap because of early termination.

III TAX PLANNING AND OTHER CONSIDERATIONS

i Overview

Swiss-resident executives are subject to worldwide taxation, subject to unilateral exemptions (real estate and permanent establishment abroad) and prevailing tax treaty provisions (such as the 183-day rule).

For internationally mobile executives, special rules apply with respect to the income taxation of employee options, RSUs, SARs and any other share awards: if an executive was not exclusively tax-resident in Switzerland during the vesting period, Switzerland will tax only that portion of the income that is attributable – in proportion of the vesting period spent in Switzerland divided by the overall vesting period – to Switzerland.[11] It is important to note that this rule applies in all cases – not only if the executive moves to Switzerland and is a Swiss tax resident upon exercise or realisation, but also if he or she has already left Switzerland and realises such income while being tax-resident outside Switzerland. In this case, the (former) Swiss employer company is required to withhold and pay the executive's Swiss income taxes. If the executive is no longer on the Swiss payroll, the Swiss employer must ensure that income taxes (and social security contributions) are finally passed on to the executive.

Depending on the applicable rules of either a social security treaty or the agreement on the free movement of persons concluded between Switzerland and the European Union, non-resident executives or executives with secondment arrangements may continue to be subject to their foreign social security system, which might be more advantageous than the Swiss system not only with respect to the (state and company) pension benefits, but also with respect to the contribution limit.

ii Expatriate tax status

Expat rules were tightened as of 1 January 2016. Executives who are seconded to Switzerland temporarily by their foreign employer may claim additional deductions from certain employment benefits, such as housing allowance and international school fees, for a maximum of five years.[12]

Because of worldwide taxation, offshore sourcing arrangements are irrelevant from a Swiss tax perspective. Foreign personal service companies may be qualified as a tax-avoidance scheme if they have no substance in the country of incorporation.

11 Example: option with vesting period of four years was granted abroad, executive moves to Switzerland after two years and exercises the option immediately after vesting. Switzerland will tax 50 per cent of the option gain (50 per cent of vesting period was spent in Switzerland).

12 Deductions as well as conditions and requirements vary among the cantons.

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IV EMPLOYMENT LAW

Except for the 'say-on-pay' legislation applicable to executives of Swiss public companies, Swiss law does not provide for any special rules in employment law that apply to executives that are different from the rules applicable to regular employees. In particular, executives who simultaneously hold positions in any corporate body – for instance, as members of the board of directors of a Swiss (privately held) company – are not subject to any special rules in terms of their remuneration, termination or any other aspect of their employment. The appointment of executives to, and their removal from, any corporate positions is governed by the relevant rules of Swiss corporate law, while Swiss employment law governs the terms and conditions of their employment. Following the implementation of the 'say-on-pay' legislation, on 1 January 2014 the remuneration of most senior executives (members of the board of directors and of the management board) of public companies in Switzerland is subject to detailed rules that have a direct and material impact on their employment contract (see subsection v).

i Non-competition

In many industries in Switzerland it is common to impose non-competition covenants on executives; within certain limits (see below), such covenants are permitted.[13] They are enforceable by specific performance, provided the relevant non-competition provision expressly allows the employer to specifically enforce the covenant. It is also common to include a liquidated damages provision in the non-competition covenant as a preventive measure. The amount of the liquidated damages will be reviewed by a Swiss court and, if considered excessive, will be reduced at the discretion of the court to an appropriate level.

A non-compete covenant is subject to certain limitations.[14] For one thing, it is only valid if the executive has access to customer data, or to manufacturing or business secrets of the employer (or both), the exploitation of which could significantly harm the employer. In addition, any non-compete covenant must be limited in terms of geographical scope, time and activity. Such statutory limitations are designed to make sure that the executive's career prospects are not unduly impaired by the non-compete covenant.

The term of the post-contractual non-compete covenant may generally not exceed three years.[15] In practice, non-compete undertakings are typically concluded for terms of between six months and two years. Although the payment of any consideration for the non-compete covenant is not a condition for its validity, it does improve its enforceability, especially if the term exceeds one year. To date, Swiss courts have not generally taken into account the length of any garden leave in determining the enforceability of non-compete covenants.

As a matter of law, any non-compete covenant will cease to apply if the employment is terminated by the employer, unless the executive has set a reason, or even provoked the termination.[16] Swiss courts at their discretion may restrict non-compete covenants in scope, if they are considered excessive.

By contrast, non-competition covenants that are entered into in the context of a transaction, such as the sale of a company by employee shareholders, are, as a general

13 Article 340ss of the Swiss Code of Obligations (CO).

14 Article 340 and 340a of the CO.

15 Article 340a of the CO.

16 Article 340c, Paragraph 2 of the CO.

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rule, not subject to the strict limitations that apply to employment contracts. Given that employee shareholders will typically receive a certain compensation for the non-competition undertaking, the relevant covenants will be enforceable even if they are broad in scope and for a term in excess of three years.

Non-solicitation covenants (either of customers or employees) are valid and enforceable under Swiss law to the same extent, and subject to the same restrictions as non-competition covenants.

ii Termination

As a matter of Swiss mandatory law, any employment may be terminated by either the employer or the employee 'for important reasons' with immediate effect.[17] Generally speaking, a termination 'for important reasons' is considered justified if the relationship between the parties has been disrupted up to a point where neither party can be expected to continue the relationship. Swiss courts are quite restrictive when it comes to admitting 'important reasons', especially if notice of termination is given by the employer.

The concept of 'constructive dismissal' has been developed by Swiss courts and doctrine, but is not based on any statutory law. According to the concept, any unilateral modification of a material term of the employment contract by the employer (e.g., the terms relating to job profile, compensation or other financial benefits) is deemed to be a dismissal of the executive. The argument of a 'constructive termination' is of particular relevance if the executive is subject to a post-contractual non-competition covenant, as such covenant will cease to be effective in the event the employment contract is terminated by the employer (see above).

A release of claims from an executive is subject to the general rules governing releases under Swiss law. The executive may only release the employer from any claims of which he or she was aware at the time the release was executed. In addition, if the executive waives a right to which he or she is entitled as a matter of mandatory law without obtaining in exchange adequate consideration from the employer, the relevant waiver or release may be deemed invalid. This rule is based on the statutory provision of Article 341 of the Swiss Code of Obligations, pursuant to which an employee may not validly waive any claims arising from mandatory law during and for 30 days after termination of the employment agreement.

iii Severance

Although Swiss employment law provides for the payment of severance upon termination of the employment to employees who are older than 50 years and who have been employed for at least 20 years,[18] the relevant provision has been superseded in practice by the compulsory company pension scheme, which was introduced in Switzerland in 1985. As a result, unless the relevant individual employment contract specifically provides for the payment of severance in the case of termination, the termination of executives does not trigger any severance payment by the employer. The same holds true for the termination of an executive as a result of a change of control of the employer: unless the executive's employment contract expressly provides that the change of control of the employer constitutes a termination event that gives rise to a special severance payment, the change of control does not affect the

17 Article 337 of the CO.

18 Article 339b of the CO.

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continued effectiveness of an executive's employment contract. Any severance payments for members of the board of directors or the management board of a public Swiss company are unlawful according to the 'say-on-pay' legislation that became effective on 1 January 2014.

iv Overtime

As a matter of Swiss public labour law, the employer is required to compensate overtime either by extra time off or by payment in cash. However, this rule does not apply to senior executives as they are not subject to the restrictions of the labour law. Senior executives are typically expected to work overtime, and their wages are deemed to include compensation for overtime. According to the labour law, a senior executive is defined as an employee who exercises a 'higher management function'.

v Restrictions applicable to executives of Swiss public companies

According to the regulations on 'say-on-pay' and on excessive executive remuneration, certain forms of compensation of the members of the board of directors, executive management board and advisory board of a Swiss stock corporation whose shares are listed on a stock exchange in Switzerland or abroad are prohibited, such as severance payments, remuneration payments made in advance and commissions related to the acquisition or transfer of businesses. In addition, loans, pension benefits, performance-related remuneration or the allocation of shares and options made to any director or executive manager are unlawful, unless expressly provided for in the company's articles of incorporation.

In addition to imposing restrictions on executive remuneration, the regulations on 'say-on-pay' introduce a limitation of one year for notice periods and for the term of fixed-term service contracts for directors and executive managers of Swiss public companies. The regulations also limit the number of board and executive management positions that any director or executive manager of a Swiss public company may hold in other companies.

Criminal sanctions may be imposed on members of the board of directors, the executive management board or the advisory board in the event of an intentional breach of the new regulations.

V SECURITIES LAW

i Participations of and trading by executives

Directors, executives and other employees of Swiss companies are neither required nor generally restricted to hold shares or other securities of the employer company. However, they have to be careful not to make use of any insider information when they trade in securities of a public company. Article 154 of the Swiss Financial Market Infrastructure Act prohibits insider trading and provides for criminal sanctions of up to five years of imprisonment. In line with the EU Market Abuse Regulation, an administrative regime against the abuse of insider information was also introduced in Article 142 of the Swiss Financial Market Infrastructure Act. Most public companies have enacted internal regulations that govern the trading in their securities and that typically provide for blackout periods during which trading is not allowed. Regulated financial institutions are subject to additional organisational requirements set out in a circular on market abuse issued by the Swiss regulator FINMA.

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ii Registration requirements

As a general rule, shares or options may be awarded to employees in Switzerland under an employee participation plan without any government authorisation, regulatory notification, filing or registration, provided that the options granted and the shares to be acquired are not listed and are not sought to be listed on a Swiss stock exchange.

Pursuant to the Swiss Federal Collective Investment Schemes Act and its implementing regulations, to offer an employee participation plan in the form of a collective investment scheme does not qualify as a distribution of a collective investment scheme and thus does not require authorisation from FINMA. The exemption, however, only applies if the employee participation plan comprises investments in the employer company or a company of the same group, is addressed to employees subject to an employment relationship that has not been terminated, and constitutes part of the employees' compensation.

Swiss corporate law requires issuers to prepare an offering prospectus whenever newly issued shares are publicly offered for subscription.[19] The prospectus requirement may also apply to the issuance of new shares in Switzerland based on the exercise of options previously allocated by an employer to its employees.

An offer is deemed public if the invitation to subscribe for shares is addressed to an 'unlimited number' of persons. Swiss law provides neither for a threshold in respect of the number of participating investors (or potential investors to whom the offer is addressed), nor for any express exemptions (such as a 'qualified investor' exemption) or similar safe-harbour rules. In line with a conservative approach, an offer directed at or made to 20 or fewer potential investors qualifies as a private offering and does not require an offering prospectus. In light of the EU Prospectus Directive and the EU Prospectus Regulation, respectively, the previous Swiss legislation governing collective investment schemes, and proposals for an amendment of the Swiss prospectus rules, this view has been criticised as being too strict. Pursuant to this more liberal approach, the number of addressees is not the only decisive criterion, and the concept of the offer being directed to a 'limited circle' of offerees also includes a qualitative element. Based on the manner in which investors are approached, an offering to more than 20 potential investors may be permissible if the offering is directed at or made to a defined circle of persons (such as employees), clearly distinct from the public at large.

Assuming a prospectus or similar information memorandum has been published abroad (e.g., pursuant to foreign regulations), such document should – for reasons of equal treatment – be also made available to the Swiss employees.

The new Swiss Financial Services Act, which has recently been passed by the Parliament, but not expected to become effective before 2020, will, among other things, provide for new prospectus rules that will replace the existing rules of Swiss corporate law. The new legislation will provide for employee participation plan exemptions that are mostly in line with the current Swiss rules. In particular, the new legislation will provide for an exemption from the prospectus requirement for securities offered or allocated by an employer or related company to existing or former members of the board of directors or executive management and its employees.[20] The impact of the new rules can, however, only be assessed once the Swiss government has published the relevant implementing ordinances (level 2 regulations), which is expected to occur later in 2018.

19 Article 652a of the CO.

20 Article 37(1)(g) of the new Swiss Financial Services Act.

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iii Reporting requirements

According to the listing rules of SIX Swiss Exchange, companies whose equity securities have their primary listing on SIX Swiss Exchange are subject to certain reporting obligations applicable to management transactions.[21] The members of the board of directors and of the executive management board have to report their transactions in equity securities, options and related financial instruments to the company within two trading days. For the purpose of disclosing management transactions, the term financial instruments includes contracts that provide or permit a cash settlement and other contracts for difference whose performance depends on the market value of the equity securities. Any acquisition or disposal made under the control of the executive and having a direct or indirect effect on his or her assets is subject to the reporting obligation. This includes securities acquired by the executive's bank based on an asset management agreement. In addition, transactions have to be reported if carried out under the significant influence of the executive by spouses, persons living in the same household, companies controlled by the executive or other related parties.

The duty to disclose management transactions to the relevant exchange formally lies with the company. Therefore, the company has to ensure that its directors and executives comply with their reporting obligations.

The Directive of SIX Swiss Exchange on Disclosure of Management Transactions exempts transactions based on an employment agreement or as part of a compensation scheme from the reporting obligation, provided that the decision whether to carry out the transaction is not up to the executive. Granting options to an executive pursuant to the terms of an employee share option plan does not trigger the reporting obligation. A notification is required only once the executive exercises his or her options or sells the securities.

The notification to the company by the executive needs to include, *inter alia*, the name and position of the executive as well as the aggregate number of the equity securities or financial instruments and the total value of the transaction.[22] The company is required to disclose the data electronically to SIX Exchange within three trading days following the notification. SIX Exchange publishes such information – except for the name of the executive and the date of notification to the company – and makes it publicly available in a database for a period of three years.[23]

iv Restrictions on cash settlement of stock options

Domestic and foreign companies with a (main) listing of their equity securities on a stock exchange in Switzerland are generally subject to the Swiss tender offer rules. These rules have to be observed in case a tender offer voluntarily includes unlisted employee share options. In the event that the (target) company acts in concert with an offeror, a repurchase of employee stock options by the company or a modification of the terms form part of the offer, resulting in the applicability of the tender offer rules. However, the possibility to provide for a cash settlement of employee stock options as such is not restricted.

21 Article 56 of the Listing Rules dated 4 April 2018 (Listing Rules). SIX Swiss Exchange enacted more detailed rules in its Directive on Management Transactions, dated 20 March 2018.

22 Article 56, Paragraph 4 of the Listing Rules.

23 Article 56, Paragraphs 5 and 6 of the Listing Rules.

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VI DISCLOSURE

Privately held companies in Switzerland are generally not required to disclose any information about their remuneration policy. In contrast, the remuneration of executives of Swiss companies whose shares are listed on the Swiss stock exchange or abroad became subject to disclosure rules that were introduced as part of proper corporate governance in public companies. According to the 'say-on-pay' legislation, the disclosure duties have been extended.

i Disclosure requirements of 'say-on-pay' legislation

Pursuant to the regulations governing the remuneration of directors and managers of public companies, the articles of incorporation of a Swiss stock corporation have to specify, *inter alia*, the maximum notice period of the employment agreements of the members of the executive management, the maximum amount of any loans and pension benefits granted to members of the board of directors, executive management board and advisory board, and the principles governing the performance-linked remuneration and the allocation of shares and options to members of the board of directors, executive management board and advisory board. The regulations allow the setting aside of a supplemental amount in order to cover the fixed remuneration of newly hired members of the executive management board after the annual shareholders' meeting.

The board of directors is required to prepare a separate compensation report annually. Such compensation report needs to specify the aggregate amount of the remuneration paid directly or indirectly to the members of the company's board of directors; the members of the company's executive management board; the members of the board of advisers (if any); and previous members of the company's board of directors, executive management board and board of advisers if such remuneration either relates to their former activities for the company or is out of line with market practice.[24] Further, any remuneration paid directly or indirectly to related persons of the aforementioned individuals needs to be disclosed on a no-name basis.[25]

In addition to the aggregate remuneration for the respective corporate body, the individual remuneration figure relating to each member of the board of directors and of the board of advisers, respectively, has to be disclosed. With regard to the members of the executive management board, it is currently sufficient to disclose the total figure together with the name, position and amount of the highest-paid executive (usually the CEO).[26]

The term 'remuneration' is defined broadly and includes any fees, salaries, bonuses, participation in turnover or the business results, services and benefits in kind, allocations of shares and conversion or option rights, sign-on bonuses, collateral commitments in favour of third parties, waivers of claims, fringe benefits and any payments or benefits for additional work.[27]

24 Article 14, Paragraph 1 of the Ordinance Against Excessive Compensation in Listed Companies (Ordinance); cf. Article 663b *bis*, Paragraph 1 of the CO.

25 Article 16, Paragraph 1 No. 1 and paragraph 2 of the Ordinance.

26 Article 14, Paragraph 3 of the Ordinance; cf. Article 663b *bis*, Paragraph 4 of the CO.

27 Article 14, Paragraph 2 of the Ordinance; cf. Article 663b *bis*, Paragraph 2 of the CO.

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Apart from the remuneration, any outstanding loans and credit facilities granted to members of the board of directors, of the executive management board and of the advisory board are to be specified in the compensation report.[28]

In addition, public companies have to disclose the participations in the company and the conversion and option rights directly or indirectly held by any current member of the board of directors, of the executive management board and of the board of advisers (or by any of their related persons).[29] The information needs to be provided on an individual basis, specifying the name and function of the respective member. The disclosure obligation is not limited to securities granted to the executive as part of his or her remuneration, but it does most likely not apply to financial instruments other than securities or conversion and option rights.

ii Further disclosure requirements

Irrespective of their place of incorporation, companies whose equity securities have their primary or main listing on SIX Swiss Exchange have to comply with the disclosure requirements set out in the SIX Swiss Exchange's Directive on Corporate Governance. The Directive applies to all types of legal entities – not only stock corporations – irrespective of the type of equity security that has been listed. Both domestic and foreign companies have to explain in their annual reports, *inter alia*, how the remuneration and the participation programmes for directors and the executive management are determined, and they need to specify the basic principles and features. Companies that are not subject to the 'say-on-pay' legislation because they are based abroad are also required to disclose the information of the compensation report (see above). The principle of 'comply or explain' applies: to the extent certain information is not disclosed, the annual report needs to give substantiated reasons for such non-disclosure.

Finally, the accounting regulations (such as IAS 24) applied by Swiss companies may require the disclosure of certain aspects of the compensation of key members of management.

VII CORPORATE GOVERNANCE

With the implementation of the 'say-on-pay' legislation with effect as of 1 January 2014, all Swiss stock corporations whose shares are listed on a stock exchange in Switzerland or abroad are subject to certain corporate governance requirements that specifically apply to executive remuneration. The requirements do not apply to companies incorporated outside Switzerland that operate in Switzerland, irrespective of whether they are listed on a Swiss stock exchange.

The main requirement regarding executive remuneration is that any compensation in any shape or form (i.e., base salary, variable salary, cash bonus, share and option grants) is as a matter of law subject to the approval of the annual shareholders' meeting. Absent such shareholder approval, a Swiss public company is not allowed to pay any remuneration to its members of the board, advisory board or executive management. Pursuant to the regulations in place, the shareholder approval may be given in advance for the following financial year or office term, or retrospectively after the end of the relevant financial year or office term. The shareholder approval does not relate to the compensation of the individual director

28 Article 15, Paragraph 1 No. 1 of the Ordinance; cf. Article 663b *bis*, Paragraph 3 of the CO.

29 Article 663c, Paragraph 3 and Article 959c, Paragraph 2, No. 11 of the CO.

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or executive, but rather to the aggregate remuneration paid to the board of the directors, the executive management and any advisory board. The shareholder approval is binding on the company and is required on an annual basis. By contrast, no approval of executive remuneration is required by any union or works council or by government.

Under the 'say-on-pay' legislation, Swiss pension funds are required to exercise their voting rights on certain subject matters, such as the election of the board of directors and the approval of the remuneration.[30] The duty to vote imposed on pension funds together with the obligation to disclose the exercise of the voting rights strengthened the position of the proxy advisers in Switzerland. However, despite the increased general sensitivity to the topic of executive remuneration, the 'say-on-pay' legislation so far has not reduced the average compensation of directors or managers.

Every Swiss public company needs to provide for a compensation committee that is elected directly by the shareholders' meeting on the basis of a proposal of the board of directors. All members of the compensation committee must also be members of the board of the company. Unlike the Swiss Code of Best Practice for Corporate Governance, which recommends that all members of the compensation committee be non-executive and independent, the 'say-on-pay' legislation does not impose any such qualification on members of the compensation committee.

VIII SPECIALISED REGULATORY REGIMES

Generally speaking, there are no regulatory regimes in Switzerland that affect the rules that apply to the remuneration payable to executives. One exception applies to the Swiss finance industry, whose regulator, FINMA, issued a circular in October 2009,[31] pursuant to which the compensation in the banking and insurance industry had to comply, *inter alia*, with the following principles:

a structure and level of compensation have to enhance risk awareness;
b any variable compensation components have to be designed to be conditional on the long-term success of the institution;
c variable compensation components must be allocated based on criteria that enhance the sustainability of the business; and
d part of the compensation needs to be deferred and subject to the future success of the institution.

The above guidelines only directly apply to (1) large banks, securities dealers and financial groups and conglomerates, which, pursuant to the applicable provisions of the Capital Adequacy Ordinance, are required to maintain equity capital in the amount of at least 10 billion Swiss francs, and (2) insurance companies, insurance groups and conglomerates, which, pursuant to the applicable provisions of the Insurance Supervision Ordinance, are required to hold equity capital in the amount of at least 15 billion Swiss francs. As for all other Swiss regulated financial institutions, FINMA recommends taking the guidelines into account when drafting their remuneration schemes. In addition, FINMA has the discretion to order, on a case-by-case basis, individual financial institutions to apply the rules (or

30 Article 22 the Ordinance Against Excessive Compensation in Listed Companies.
31 FINMA Circular 2010-1 Remuneration Schemes, issued on 21 October 2009, effective as of 1 January 2010, last amended on 22 September 2016.

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only selected rules) set out in the remuneration circular. Although the legal validity and enforceability of these FINMA guidelines are not entirely clear, the rules promulgated therein have set a standard of 'best practice' in the Swiss finance industry.

IX DEVELOPMENTS AND CONCLUSIONS

Despite initial concerns, Swiss public companies were able to manage the implementation of the 'say-on-pay' legislation without major problems. So far, shareholders have always – and mostly with clear majority – approved the executive remuneration of Swiss public companies as proposed by their boards of directors.

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Appendix 1

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Dr Matthias Oertle is a partner in the Zurich office and heads the employment and pensions practice. Mr Oertle attended the University of Zurich in 1986 (*lic iur*) and in 1990 (*dr iur*). He was admitted to the Zurich Bar in 1988 and joined Lenz & Staehelin in 1991, becoming a partner in 1996. Some of the works of which he is author and co-author include 'Employment and Labour Law – Switzerland', in *European Lawyer Reference Series* (fourth edition, London 2012); 'Employment Law in Conflict with the Regulations regarding Excessive Executive Remuneration', *Gesellschafts- und Kapitalmarktrecht* 1/2014, p. 44 ss; and 'Commentary on the Regulations regarding Excessive Executive Remuneration, Art. 28', *GesKR-Kommentar VegüV* (Zurich/St Gallen 2014).

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Ms Stadtherr-Glättli is a member of the International Fiscal Association and the Swiss Fiduciary Chamber. She is a lecturer at the Swiss Tax Academy for international taxation, expatriates and social security treaties.

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