CORPORATE GOVERNANCE IN SWISS LAW AND PRACTICE

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REGULATION OF CORPORATE GOVERNANCE IN SWITZERLAND

Developments on the Legislative Side

In the wake of a series of financial scandals involving major corporations such as Swissair and ABB in 2001, a relatively large number of parliamentary motions were submitted with the objective of having the Federal Council – Switzerland's supreme executive body – subject the existing body of law to a review in terms of corporate governance. Based on the findings of various expert reports, the Swiss Parliament passed a preliminary draft bill in 2005 for a transparency law that compels listed companies to provide detailed disclosures of the holdings and compensation of board of directors and executive management members.

The Federal Council launched the so-called "major" company law reform with its dispatch of December 2007. This reform is actually partial in nature in that existing statutory cornerstones of corporate governance are left untouched for the most part whereas various specific, in part significant amendments will be implemented. Whoever initially had the impression that, after the long tale of woe associated with the last major company law reform from 1968 to 1991, the draft bill would be passed quickly and without much fanfare was in for a disappointment. Due to the popular initiative spearheaded by mouthwash manufacturer Thomas Minder in February of 2008 against "fat-cat" pay deals, which triggered an emotionally charged political debate on the compensation of top executives of listed companies, Swiss company law reform has again come to a standstill. The decisive event that has determined the further course for resuming the suspended reform took place on 3 March 2013, when Swiss voters overwhelmingly backed the initiative giving shareholders sweeping authority over executive pay. The implementation of the Minder initiative, with 24 substantive points, will still be a matter of parliamentary law-making. Nevertheless Mr Minder put into the amendment the supplement that for the period of time until the law enters into force and effect, the federal government shall, within one year of adoption of the amendment, issue the necessary implementing provisions. Thus, the Ordinance Against Excessive Compensation in Listed Companies implementing Minder has already been issued by the Federal Council, on 20 November 2013. The Ordinance obliges listed Swiss companies to annually submit the top management's compensation to shareholders for a binding vote, but leaves it to the company to set out the details of the vote in its articles. It 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. So for example, 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. 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, advance compensation or incentive payments for restructurings within the group, whereas compensation for entitlements that forfeit upon leaving the previous employer is still allowed. Moreover, the company's articles of association amongst others must make provision for 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. Finally, the Ordinance provides for criminal prosecution where compensation rules are violated against better knowledge.

Some of the provisions are already to be complied with as of the entry into force of the Ordinance on 1 January 2014. Since companies need to properly prepare and organise their shareholders' meetings, the Ordinance however provides for transition periods to adapt the articles of association and the regulations to the new law, so that the first ordinary shareholders' meetings to be affected by most of the new provisions are the ones to be held in 2015.

Regulated Self-Regulation by the SIX Swiss Exchange

Outside the bounds of company law, the Swiss Stock Exchange Act obligates stock exchanges to regulate the admission of securities for trading. Following from this authorisation, in its Listing Rules the SIX Swiss Exchange has established, among other things, what information must be disclosed by issuers.

As is the case in most European countries, however in contrast to Germany, Swiss securities exchanges are not public-law entities but rather are constituted as companies under private law. As such, their rules must be qualified as regulated self-regulation measures.

I would like to underscore the Corporate Governance Directive, which the SIX Swiss Exchange issued on the basis of its statutory-based self-regulation powers and on the basis of relevant provisions of its Listing Rules. The Directive compels issuers to make available to investors specific key corporate governance information, to wit details pertaining to the group structure, significant shareholders, and the capital structure as well as specific particulars on the members of the board of directors and executive management, such as their professional career, their business relations with the company, other functions and their position within the group.

The comply-or-explain-principle extends to all disclosures in the notes of an annual report. This means that where an issuer departs from the Directive in a disclosure item, it must include a justification in the annual report. The self-regulation of stock exchanges does not interfere in the internal checks and balances within a company in terms of corporate governance and does not impose any conditions pertaining to a company's individual governance mechanisms, but rather its focus is on enhancing transparency in a listed company's operations.

RECOMMENDATIONS OF THE SWISS CODE OF BEST PRACTICE FOR CORPORATE GOVERNANCE

In 2002, at the same time as the Corporate Governance Directive was issued, Economiesuisse, the federation of Swiss businesses, issued its Swiss Code of Best Practice for Corporate Governance.

Purpose and Legal Significance of the Swiss Code

The purpose of the Swiss Code is to set out guidelines and recommendations, but not force Swiss companies into a straitjacket. Each company should retain the possibility of putting its own ideas on structuring and organisation into practice. Hence, the Swiss Code emphasises the discretionary freedom of companies and is restricted to legally non-binding recommendations of best management practice and supervision.

In contrast to a prevailing international trend, the Swiss Code is still not subject to compliance by companies as a precondition for listing on the Swiss Stock Exchange according to the "comply or explain" principle. Consequently, there is no obligation under stock exchange law to comply with the Swiss Code. It constitutes "soft law" based entirely on private autonomy, and ultimately also does not possess any democratic legitimacy. By formulating best practice recommendations, the Swiss Code enjoys widespread acceptance in the marketplace because it shows practical solution approaches that are based on expertise and experience. It compensates its legal legitimacy gap so to speak by being objectively convincing in and of itself.

Content of the Swiss Code

The areas covered by the Swiss Code are embedded in prevailing company law. The Swiss Code largely fleshes out basic principles outlined in law and provides board and top management best practice recommendations for utilising their scope for action under the law. In doing so, it implicitly expresses that good corporate governance is basically nothing other than properly understood company law.

The recommendations, which deal specifically with shareholder relations, hold the board of directors and management to a clear-cut fundamental attitude, that is shareholders are to be taken seriously, decision-making is to be facilitated in meetings of shareholders, and communication is to be improved between the company and its capital providers. The guidelines of the Swiss Code pertaining to the responsibilities of the board of directors' in performing its management duties ensue in part explicitly and in part implicitly from applicable company law. As to auditing, the Swiss Code of Best Practice for Corporate Governance is content with a reference to statutory provisions and applicable independence guidelines. Also with regard to the disclosure of specific key information on corporate governance, the Swiss Code makes exclusive reference to the Disclosure Directive of the SIX Swiss Exchange.

Adaptation of the Swiss Code in keeping with Current Developments

Despite the widespread intensive discussion on the colourful phenomenon of corporate governance in the international arena it is nonetheless surprising that the Swiss Code has remained unchanged for the most part since being issued 10 years ago. It was amended in 2007 as a spontaneous reaction to the public debate on the compensation of the top management of listed companies. Economiesuisse decided to issue specific recommendations and explanations in a separate annex to the Swiss Code concerning the way boards of directors should deal with the compensation of board members and executive management.

In July 2010 the UK Stewardship Code initiated an international discussion on a stronger inclusion of institutional investors in corporate governance. They were to be advised to disclose their voting conduct and exercise their voting powers responsibly. In the process proxy advisers – who provide institutional investors various services – also became the target of criticism. As a result of this development, Economiesuisse decided in February of 2011 to take up the topic of the exercise of voting rights on the part of institutional investors by focussing on this issue in reforming the Swiss Code and to otherwise exercise restraint and amend it only in individual points. It then commissioned a working group to look into supplementing the Swiss Code by adding guidelines pertaining to institutional investors and their proxy advisers. The findings of this working group were discussed with selected representatives of Swiss companies, institutional representatives and other interested parties; they have been published on 21 January 2013.

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With the anticipated reform of transparency concerning the compensation of executive bodies, the approval of the Minder-initiative and its implementing ordinance-limiting "fat cat" executive pay and the major reform of company law now relaunched, the legislator has recently made it clear that central corporate governance issues such as control by shareholders and the interaction between the shareholders' meeting and executive bodies are to remain the subject of statutory law. Where the task is to weigh the interests of the various stakeholders in a company against public interests in an authoritative manner, this can only be done by the legislator due to reasons of democratic legitimacy. The enactment of laws may also be necessary on account of associated legal constraints. In going about regulation, the coherence of company law must be maintained.

Nevertheless self-regulation by the stock exchange or codes of conduct has not become obsolete as regulatory instruments. In view of the enormous time pressure to which legislative processes are increasingly being subjected in the area of corporate governance, a more contemporary approach nevertheless continues to be perceived in the regulatory model in which framework legislation is combined with self-regulation. Statutory law and corporate governance codes can supplement one another so as to form a market-consistent and flexible order that possesses democratic legitimacy.

As such, the current blend of various aspects has also proven itself an effective approach to regulating corporate governance in Switzerland. A flexible, basic foundation of soft law is combined with a few domestic elements or hard core requirements; the end result is easily and widely accessible to management and to the public.