

## Company & Commercial - Switzerland

### 'Fat cat' initiative revisited – government implements ordinance

Contributed by **BADERTSCHER Rechtsanwälte AG**

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In Spring 2013 Swiss voters approved the 'fat cat' initiative by amending the Swiss Constitution (for further details please see "[Voters say yes to 'fat cat' initiative](#)"). The federal government has adopted the respective implementing ordinance, which became effective on January 1 2014. The new ordinance against excessive salaries clarifies many open questions for the around 240 Swiss companies listed on either a Swiss or foreign stock exchange. Several say-on-pay issues are left to the decisions of the shareholders meeting. The criminal penalties are more lenient than in the first draft.

#### Key issues

##### ***Forbidden forms of compensation and related criminal provisions***

The following forms of compensation for board, top management board and advisory board members are explicitly forbidden (ie, null and void) if agreed on:

- severance or other compensation payments (eg, 'golden parachutes')
- pre-payments (eg, 'golden handshakes');
- bonuses for acquisitions or divestitures of subsidiaries, or parts thereof, directly or indirectly controlled by the Swiss listed company;
- loans, credits and pension benefits not foreseen in the Swiss listed company's articles (or in occupational pension schemes); and
- pay out of listed shares, conversion and option rights not foreseen by the articles.

The new ordinance specifies that only the first three forbidden compensation types are subject to penal provisions. In these first three cases, board members, top management and the advisory board are liable to imprisonment of up to three years and a monetary penalty if they grant them to others or accept them themselves, provided that they acted with direct unlawful intent. Other transactions entered into with direct unlawful intent to avoid the new ordinance are also issued with the same penalties. This applies to:

- delegation of top management functions to another legal entity, other than for asset management purposes (ie, group management companies are no longer allowed);
- compensation payments beyond the amounts approved by the annual general meeting (AGM);
- execution of mandates outside the Swiss listed company group in excess of the respective statutory maximum amount; and
- active impediments of ordinance implementation within the AGM.

However, the 'direct unlawful intent' requirement is rigid under Swiss penal law, as a result of which the new penal provisions will foreseeably be of limited importance in practice. Only the conscious payment or receipt of non-approved compensations and other conscious infringements of the new ordinance against better knowledge are included.

Severance payments required by law (eg, labour law is particularly relevant in some foreign jurisdictions), compensation payments for non-competition covenants, compensation for loss of entitlements and bonus payments for acquisition or divestiture of companies not controlled by the Swiss listed company are still allowed to the extent that they reflect a fair market value. The AGM may also adopt an extra amount for new hires

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not then known, which allows the Swiss listed company to make the new hires before the next AGM and to grant them a signing bonus to the adopted amount (eg, as compensation for entitlement losses with the previous employer).

### ***Viable say-on-pay models***

The new ordinance stipulates only that the AGM must separately and bindingly vote each year on the total amount of compensation payments for the board, top management and board of advisers, whereby the ordinance does not favour any specific model. Each Swiss listed company may choose its own compensation determination model and has, for example, the following possibilities for as long as it is fully reflected in the articles:

- prospective voting on fixed compensation (valid until the next AGM) combined with retroactive voting on the performance fee (based on the previous business year's results);
- as above, whereby, however, the reference period for the prospective fixed compensation begins some months after the AGM (eg, in the middle of the year);
- prospective voting on a compensation budget for the fixed and performance-based compensation portions (whereby the reference period of the business year can be altered to other 12-month periods); and
- prospective voting for the following business year (whereby the reference period for the performance-based compensation could be altered by a retroactive voting introduced in this respect).

Prospective voting enables the board and shareholders to know what to expect in the future. However, shareholders may be reluctant to agree to huge compensation amounts in advance. A consultative retrospective voting or a combination of prospective voting for fixed compensation amounts with a retrospective voting for variable amounts based on performance goals may thus better serve the interests of the shareholders. All retrospective voting enables shareholders to make a decision based on actual financial results. However, the board cannot foresee the shareholders' reaction in advance, and a shareholder may react differently from expected and deny compensation payments expected in good faith.

### ***Summary of required amendments to the articles***

Amendments to the articles of Swiss listed companies must include the following:

- exclusive competence of the shareholders meeting to elect board members and the compensation committee of the board; however, not the members of board committees or top management;
- responsibility of the board of directors to issue a compensation report;
- exclusion of officers or custodians from acting as shareholder proxies at general meetings;
- introduction of proxy voting by an independent shareholder representative; and
- introduction of the following rules:
  - numbers and types of permitted additional positions and mandates for board members, top management and the compensation committee (whereby positions and mandates abroad also count towards the maximum foreseen in the articles);
  - duration of employment and mandate agreements of board members and top management;
  - provisions about the responsibilities and principal tasks of the board's compensation committee; and
  - detailed provisions about voting on compensation payments, including the course of in case of negative shareholder votes on compensation.

### ***Transitional implementation rules***

The following must be implemented by Swiss listed companies at the 2014 AGM:

- shareholders must elect the chairman of the board (who previously could be appointed only by the board itself on election of all board members by the AGM);
- all board members and members of the board's compensation committee must be elected or re-elected for a one-year term only (which also applies to members originally elected for longer terms, whereby re-elections at the next AGM are allowed);
- board members must each be elected by an individual AGM vote;
- the board must appoint an independent proxy who must be elected by the AGM and may be appointed by shareholders to vote on their behalf at the AGM; and
- amendments of the articles to give effect to the new ordinance are also recommended, they are, however, not yet mandatory for 2014.

The following must be implemented by Swiss listed companies at the 2015 AGM:

- all required article amendments;
- all required company regulations (eg, on the responsibilities of the compensation committee);
- electronic voting must be possible for shareholders by instructions to an independent proxy pre-appointed by them;
- a report on the overall compensation of the board, top management and supervisory board must be presented to the AGM by the board for the fiscal year 2014; and
- voting on the compensation of board members, top management and advisory board must occur.

From January 1 2016 all employment agreements must be amended to comply with the new ordinance. In particular, the term and notice period for board members, top management and supervisory board may not exceed 12 months.

## Comment

Swiss listed companies must start early to implement all changes to their articles, other regulations, employment contracts (including bonus systems and participation plans), as well as AGM voting procedures, as these decisions fundamentally affect the rights of their shareholders. Likewise, foreign board and top management members contemplating joining a Swiss listed company should familiarise themselves with special Swiss requirements early, with a view to avoiding personal liability. Shareholders with important interests in Swiss listed companies are also advised to inform themselves well in advance of the next AGM about the opportunities offered by the new Swiss say-on-pay rules.

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