

Changes in law keep Swiss standards high



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At the core of Switzerland's legal corporate governance framework is the Swiss Corporation Law (which forms part of the Swiss Federal Code of Obligations). Most governance issues are covered by existing corporation law, particularly the provisions on boards of directors and on transparency, followed by Best Practice Rules developed in this context. Recent developments in the Swiss Stock Exchange Law and forthcoming changes in corporation law will ensure that the corporate governance standards in Switzerland live up to international best practices.

Swiss law provides for a one-tier-system as the basis of corporate governance – the board of directors not only exercises the supervisory functions, but also manages the business. However, Swiss law is extremely flexible (which explains why stock corporations are the most popular form of organization for all types of business purposes) and allows the delegation of management to either individual board members or an executive board. In practice, all of the larger Swiss corporations and 100% of the corporations listed on the SWX Swiss Exchange have delegated the management functions to an executive board, leaving the board of directors to concentrate on supervisory functions.

The law allows one person to be both the chairman of the board of directors and the chief executive officer, but it is considered best practice to separate the two functions, which is now the practice of most large corporations.

A special feature of Swiss corporation law is the mandatory allocation of certain non-transferable duties to the board of directors. These duties encompass the ultimate management of the corporation, the establishment of its organization, the structuring of the financial control and the financial planning, and the appointment and removal of the persons entrusted with the management, as well as their ultimate supervision. A Swiss board of directors, therefore, may never limit itself to the functions of a German supervisory board.

The members of the board of directors as well as any person entrusted with the management of a corporation are personally liable towards the company, its shareholders and – in case of bankruptcy – its creditors for any damage caused by an intentional or negligent violation of duties. There have been only a few cases in which lawsuits were filed against board members and managers of a company that is in good standing, but such lawsuits have become routine in the event of bankruptcy. Auditors are subject to the same liability.

In particular for corporations listed on the Swiss Exchange, the legal requirements are supplemented by rules of soft law and self-regulation: The Swiss Code of Best Practice of Corporate Governance, drawn up by the Swiss Business Federation, and the Directive on Information relating to Corporate Governance issued by the SWX Swiss Exchange.

The Swiss Code is a set of non-binding recommendations on best practice for public companies. It deals with shareholders' rights and the functions and organization of the board of directors and the executive board. The purpose of the Swiss Code is "to set out guidelines and recommendations, but not force Swiss companies into a straight jacket. Each company should retain the possibility of putting its own ideas on structuring and organization into practice."

The Directive on Information of the SWX aims to enhance transparency on the governance rules of stock corporations. It applies to companies listed on the SWX Swiss Exchange and is enforced by SWX. The Directive sets out a list of issues to be addressed by each listed company in its annual report. In principle, corporations may either disclose information or explain why they decide not to (*comply or explain*). The topics relate to corporate and capital structure, main shareholders, the board of directors and management as well as its members and their compensation in case of a change of control, shareholders' rights, auditors and the corporation's information policy. There is one exception to the comply-or-explain principle: information regarding the compensation of the board of directors and of the executive board is compulsory. The information encompasses all elements of remuneration and must be broken down into its components, such as cash payments, awards of shares and stock options and pension plan benefits. The information must be provided with respect to the board of directors as a whole and the executive board as a whole. Individual compensation need not be revealed, with the exception that the highest compensated members of the board of directors must be singled out (without mentioning the identity of that member, although in most of the cases this is readily apparent anyway).

Today, compliance with these rules is quite high: among the listed companies, adherence is at 94%, and for the large corporations that comprise the Swiss Market Index (SMI), the percentage is even higher, at 96%.

Starting July 1 2005 members of the board of directors and the executive board of companies listed on the SWX Swiss Exchange will be required to disclose transactions in shares of their company. This disclosure obligation aims to allow shareholders and investors to draw conclusions from investment and divestment decisions of insiders. The obligation extends to transactions in shares, derivatives in shares and any financial instruments, the value of which is determined by the share price. Exempted are transactions that form part of a person's compensation. Transactions of a person exceeding SFr100,000 (approximately \$80,000) within one calendar month must be disclosed to SWX within two trading days, whereas all other transactions have to be included in a collective notification by the company within four trading days after the end of the month. The information is disclosed by SWX on an internet database, with specific details on the transactions and generic information on the function of the buying or selling person.

The concept of hard law supplemented by soft law is being challenged by a legislative project on the disclosure of financial benefits granted to the members of boards of directors and executive boards of listed companies. The proposal will make disclosure on compensation part of mandatory law. Disclosure would also be expanded, as the proposed rule would require the compensation of each member of the board of directors to be revealed individually. No such obligation is proposed, however, with respect to the executive board, with the exception that the compensation of the highest paid member (usually the CEO) would have to be disclosed separately. The proposal is being challenged, on the one hand, by supporters of the existing level of information and self-regulation and, on the other hand, by critics who want full transparency of the total compensation of each individual member of the executive board.

Other proposals for an amendment of the Swiss Corporation Law are also relevant in terms of corporate governance issues. Overall, the agenda of the Swiss legislators concurs to a great extent with the proposals in the EU's action plan on company law. The developments focus on: enhancing the flexibility of shareholders' meetings, particularly strengthening the right to be represented by proxies, the use of electronic devices and cross-border-voting; implementing a more flexible capital structure; and lowering the thresholds for the exercise of minority rights, such as placing an item on the agenda of a shareholders' meeting. In this context, the position of institutional investors such as pension funds becomes more important.

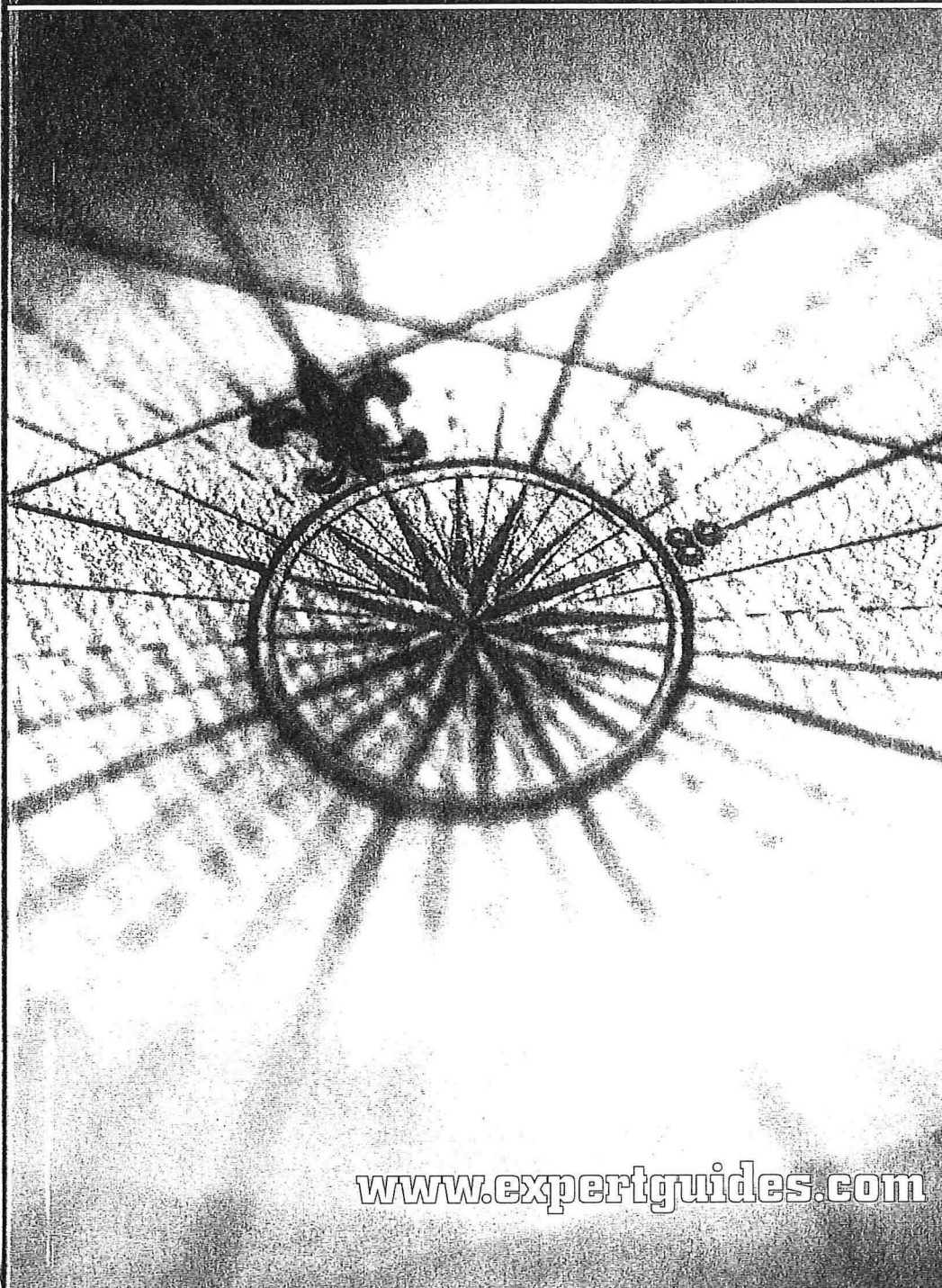
The disclosure issues will be implemented soon pursuant to separate acts of the Swiss legislators, but the additional governance developments will form a package of new Swiss corporation law that is not expected to come into force before mid-2007.

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