

Say on Pay in Switzerland Minder Initiative Wins Popular Vote

On March 3, 2013, in a nation-wide vote the Swiss decided to amend the Constitution as proposed by a constitutional initiative launched by Thomas Minder (the „Minder Initiative“). The Minder Initiative toughens the formal corporate governance regime. However, due to the need for implementing legislation, the exact scope of the revision remains uncertain at this point in time.

As a consequence of the Minder Initiative, the Swiss corporate governance framework will be amended as follows:

- The aggregate compensation of the board of directors and the senior management will be subject to the approval of the general meeting of shareholders;
- Severance payments (golden parachutes), advance payments and similar extraordinary payments to directors or senior managers, as well as multiple contracts between directors and senior managers and group companies will be prohibited;
- The articles of association will have to include rules for directors and senior managers on loans, retirement benefits, incentive and participations plans, and the number of positions outside the group;
- The chairman of the board, the board members, the members of the board's compensation committee as well as the independent proxy will have to be elected annually by the general meeting of shareholders; and
- Companies will no longer be allowed to act as corporate proxies but will need to allow shareholders to cast their votes electronically from a remote location.

As a result of the constitutional amendment, a say on pay bill will have to be drafted and passed by the legislature. Before (and subject to) the enactment of the bill into law, the Swiss Government will have to issue an implementing ordinance so that the new constitutional principles become effective as soon as possible. Pursuant to the Minder Initiative, the ordinance of the Swiss Government must be enacted no later than March 3, 2014 (although the ordinance may enter into force at a later date and, in various respects, transitional provisions will give the companies time to adapt to the new rules).

The Text of the Constitutional Amendment

The Swiss approved that the following amendment to the Federal Constitution of April 18, 1999:

Art. 95 para. 3 (new) (unofficial translation)

³ *To protect the economy, private property and shareholders and in line with sustainable corporate governance, Swiss joint stock corporations listed in Switzerland or abroad shall be regulated by law according to the following principles:*

- a) The general meeting of shareholders shall vote annually on the aggregate amount of all compensation (cash and value of compensation in kind) of the board of directors, senior management and the advisory board. The general meeting of the shareholders shall elect the chairperson of the board of directors, each member of the board and of the board's compensation committee individually as well as the independent proxy. Pension funds shall vote in the interest of their members and must disclose how they voted. Shareholders may vote electronically from a remote location; corporate proxies and representation of the shareholders by depositary banks are prohibited.*
- b) Directors and senior managers shall not receive golden parachutes or any other compensatory payments, advance payments, bonuses for buying or selling companies, and not enter into additional employment or consulting agreements involving another company in the group. The management of a company may not be delegated to a legal entity.*
- c) The articles of association shall provide for rules on the amount of credits, loans and retirement benefits, and incentive and participation plans, for directors and senior managers, as well as the number of positions directors or senior managers may take on outside the group as well as the duration of the senior managers' employment contracts.*
- d) Contraventions of any provisions set out in lit. a)-c) shall be punishable by imprisonment for a term of up to three years and a fine of an amount up to the equivalent of six years' of annual compensations.*

In addition, the transitional provisions of the Federal Constitution will be amended as follows:

Art. 197 clause 8 (new)

8. *Transitional provision regarding article 95 para. 3*

Pending the enactment of a bill into law, the Federal Government shall issue the necessary implementing ordinance within a year from the date the Swiss People and Cantons approved article 95 para. 3.

Expected Legislation

As a result of the constitutional amendment, Parliament will need to draft and enact into law a bill implementing the constitutional mandate. The legislative process to draft, read, and finally enact a bill will take time, and the outcome of the legislative process is uncertain. No legal means exist to force Parliament to implement constitutional rules in any particular way.

Moreover, Parliament enjoys substantial discretion in determining how to implement the constitutional mandate and may decide to address other issues that are not directly within the scope of the constitutional

initiative. Thus, the specifics of the implementing legislation are uncertain. Currently, it is generally expected that, where the text of the Minder Initiative leaves room for interpretation, the legislation to implement the Minder Initiative will follow the more detailed rules of the counterproposal, which had been approved by Parliament as an alternative to the Minder Initiative and are generally perceived to be more business-friendly. Therefore, the final outcome is likely to be a legislation that is true to the language of the constitutional amendment yet, to the extent possible, attuned to the needs of Swiss corporations. At the same time, the left and some voices from within the majority have already announced their intention to move for other reforms to the corporate governance framework, thus foreshadowing protracted discussions in Parliament until the bill is enacted into law.

The Minder Initiative sought to avoid this issue by mandating the Federal Government to adopt the necessary rules to implement the constitutional article by March 3, 2014. The Federal Government is expected to organise a consultation based on a first draft of the ordinance by the summer of 2013. Because these exceptional legislative powers are limited to the implementation of the constitutional article, without any power to legislate on other related issues, the Federal Government will have less discretion in drafting its implementing ordinance.

Key Issues

Individual Annual Elections of Directors and independent Proxy

The new constitutional provision mandates individual, annual elections of the members of the board of directors, the chairperson, the members of the compensation committee and the independent proxy.

Existing Rules

Individual or collective election of board members by the shareholders' meeting for a term of up to three years if articles of association do not provide for different regime.

Board elects its chair unless the articles of association reserves such competence for the shareholders' meeting.

New Constitutional Provision

Annual election by the shareholders' meeting not only of each member of the board but also of the chairman and each member of the board's compensation committee.

New Approval and Disclosure Requirements on Compensation

The new constitutional provision requires votes on the compensation of each of the board of directors, the advisory board (if any) and the management of a Swiss listed company. The implementing legislation will need to define the specifics of the shareholder vote. While it seems to be uncontroversial that the votes on the aggregate compensation of the board of directors and the advisory board (if any) are binding there are politicians and legal commentators who take the view that the approval of the aggregate compensation of the management is of an advisory nature only.

Taken literally, the constitutional amendment seems to require an annual vote on an aggregate amount, which can then be used to fund various elements of the compensation package of the members of the board of directors, senior management and the advisory board, without specifying whether this ballot should be

cast in advance or after the fact. In practice, since granting a fixed amount in advance would contradict the most elementary notions of paying for performance, while expecting directors and officers to work for the corporation without any contractual claim whatsoever to compensation is hardly practicable, it is likely that some kind of middle ground will need to be found between both approaches.

In this context, the counterproposal is likely to serve as a base-line that could be adjusted to reflect the constitutional mandate: the board would be required to prepare compensation regulations, which would define the key elements of the compensation policy and be subject to shareholder approval. The general meeting of shareholders could, then, cast a vote on a compensation budget for the coming year, which could be used to fund both fixed and variable compensation according to the principles defined in the compensation regulations. It would be still possible to offer additional compensation, if the budget proved to be insufficient to cover the variable compensation plan or if exceptional circumstances required the payment of an additional amount. However, such payments would be conditional on the approval of the general meeting held the subsequent year.

In addition, pursuant to the new constitutional provision, the articles of association will need to contain rules on the amount of credits, loans and compensation plans that may be granted to directors and managers and incentive and participation programs, the number of positions directors/managers of the relevant company may have outside the group as well as the duration of the managers' employment contracts. It remains unclear whether these provisions will be only need to include general rules on these issue or whether they will have to include specific disclosures relating to each director and manager.

Existing Rules

No shareholder approval on executive compensation required.

Some listed companies have introduced advisory votes.

New Constitutional Provision

Aggregate compensation of the board of directors, the management and the advisory board (if any) is subject to approval by the shareholders at the annual general meeting.

The shareholders' resolution is binding (not only advisory although this is not yet entirely clear with respect to the shareholders' vote on the compensation of the management). The articles of association must contain rules on the amount of credits, loans and compensation plans that may be granted to directors and managers and incentive and participation programs, the number of positions directors/managers of the relevant company may have outside the group as well as the duration of the managers' employment contracts.

Contracts with Members of the Board and Group Management

Pursuant to the new constitutional provision, severance payments, advance payments, bonuses in connection with purchases or sales of companies, and any additional employment or service agreement with members of the board or senior management in the group are prohibited.

The scope of the restriction that there be no additional employment or service agreements between a director or senior manager and any group company (other than the listed Swiss corporation) remains unclear. The purpose of this restriction is to prevent agreements between directors or senior managers and non-listed

companies within the group to circumvent the shareholders' approval requirement, which only applies to listed Swiss corporations. Therefore it remains to be seen whether the legislature will consider that this purpose is met by submitting compensation packages for approval to the shareholders on a consolidated basis, in which case a prohibition of multiple contracts would seem unnecessary.

Existing Rules

No existing rules (other than generally applicable corporate benefit rules).

New Constitutional Provision

Severance payments, advance payments, bonuses in connection with purchases or sales of companies, and additional employment or service agreements with members of the board of directors or senior management in the group are prohibited.

New Rules in Relation to General Meeting of Shareholders

- Electronic Voting: The new constitutional provision requires the introduction of electronic voting from a remote location.
- Abolition of Corporate Proxies: The new constitutional provision prohibits corporate proxies and representation of the shareholders by depositary banks. In consequence, companies will only have the possibility to offer the shareholders the possibility to vote their shares through the independent proxy who will have to be elected by the shareholders. Proxy cards, proxy statements and AGM notices will have to be amended accordingly.
- Pension Funds: The new provision states that pension funds must vote in the interests of their members and disclose how they voted. The current view is that only pension funds regulated by Swiss social security laws will fall within the scope of this requirement.

Future Developments and Next Steps

The new constitutional provision is not self executing and requires implementing legislation. Therefore, the specific consequences of the new constitutional provision are, to a large extent, still uncertain. Further clarity is expected to come by summer 2013, when the Federal Government is expected to organise a consultation on the draft of the implementing ordinance. However, the final implementation of the constitutional provision will be known only once Parliament enacted a bill into law. The new law will then be subject to a possible referendum, which, if requested by 50,000 Swiss citizens, will lead to another nation-wide vote.

Notwithstanding these uncertainties corporate issuers should prepare for the upcoming regulations and consider action in the following areas:

- Review their compensation policy to align them with the principles of the constitutional amendments and be ready for a shareholder ballot;
- Revise their articles of association to bring them in line with the requirements of the new constitutional provision and include the requisite disclosures;
- Prepare for the changes to the conduct of future general meetings.

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