

Say on Pay in Switzerland

Heated debate over proposed laws on executive compensation goes into final round

By Ralph Malacrida and Till Spillmann

Recent decisions of Swiss Parliament and opinion leaders have paved the way for a nation-wide ballot of the Swiss people on executive pay as early as March 2013.

Amid financial turmoil and public outrage over excessive management compensation by financial institutions that received taxpayers' support a popular initiative, the so called Rip-Off Initiative (*Abzocker-Initiative*), was launched in 2008 aiming to subject board and management compensation to the mandatory approval by the shareholders of Swiss listed companies. The initiative involves a citizen-proposed amendment of the Swiss constitution, which – if passed by the Swiss voters – will result in Parliament having to prepare and draft a bill to specify the general principles laid down in the proposed constitutional amendment.

Since the Rip-Off Initiative is perceived as anti-business, Parliament has been grappling to ensure that a counter-proposal is put forward when the Rip-Off Initiative goes to a nationwide ballot - in the hope that a majority of the people and the cantons will reject it. Parliament's counterproposal addresses most of the Rip-Off Initiative's concerns but seeks to ensure a more flexible and balanced regime setting out a level playing field comparable with say on pay regulations of other major jurisdictions.

Only two weeks ago, the committee backing the Rip-Off Initiative confirmed that it will not withdraw its initiative and that it will fight against Parliament's counterproposal. Therefore, the Swiss people is expected to vote on the Rip-Off Initiative and the counterproposal in March 2013. A second counterproposal, known as the Bonus Tax, that sought to introduce a regime limiting the tax deductibility of compensation payments to an amount corresponding to CHF 3 million per year and per recipient in both listed and non-listed companies has recently been rejected in Parliament.

The following overview shows the key elements of the proposals that will be put to the nationwide vote.

Individual election of directors to strengthen accountability

The new rules proposed by the Rip-Off Initiative feature an individual annual election of the members of the board of directors and the chairman of Swiss listed companies to enable shareholders to vote on each board members' individual performance. The counterproposal includes the possibility of extending the minimum term from one to three years and having the chairman appointed by the board of directors.

In order to increase control over the compensation committee the Rip-Off Initiative requires the shareholders to elect the members of that committee. The counterproposal is silent on the compensation committee, which continues to be appointed by the board of directors.

The rules on the election of the directors according to the existing rules, the Rip-Off Initiative and the counterproposal can be summarised as follows:

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 chairman unless the articles of association reserves such competence for the shareholders' meeting.

Rip-Off Initiative

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.

Counterproposal

Annual election by the shareholders' meeting of the members of the board and the chairman. However, shareholders may opt for a different regime in the articles of association (election of chairman by the board, no annual re-election and terms of office up to three years).

New approval requirements and disclosure rules bolster shareholders' say on pay

Whilst the Rip-Off Initiative requires binding votes on the compensation of each of the board of directors, the advisory board (if any) and the management of a Swiss listed

company (whether this is a prospective or retrospective vote remains unclear), the counterproposal takes a more nuanced approach. Pursuant to the counterproposal the aggregate compensation of each of the board of directors and the advisory board (if any) is subject to a binding vote. However, with respect to management compensation the articles may state that the requested shareholders' approval shall be advisory only.

Furthermore, the counterproposal draws a distinction between a base compensation (*Grundvergütung*) and an additional compensation (*zusätzliche Vergütung*) and specifies that the base compensation must be approved for the time period between the relevant annual general meeting and the next annual general meeting (i.e. the vote on the base compensation would be of a prospective nature) whereas the additional compensation must be approved for the past business year (i.e. the vote on the additional compensation would be retrospective). The base compensation can comprise both fixed and variable components (including in particular a bonus) but must in any event be limited to a maximum amount (cap) approved by the shareholders. Any compensation in excess of the cap is permissible only if approved by the shareholders in connection with the vote on the additional compensation after the end of the relevant business year.

In addition, according to the Rip-Off Initiative, severance payments, sign-on bonuses, success-related compensation in connection with purchases or sales of companies, and any additional advisor's fees or employee compensation within the group for the benefit of board members or management are prohibited. 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. It remains unclear whether the disclosure can be of a generic nature or specific disclosures will need to be made. The counterproposal mirrors this by a less burdensome proposal requiring the board of directors to set out most of this information in compensation regulations (*Vergütungsreglement*). The board of directors is obliged to prepare such compensation regulations and obtain shareholders' approval. Shareholders holding 0.25% or more of the share capital or voting rights or shares with an aggregate nominal value of CHF 1 million or more are entitled to request a vote on any amendment of the compensation regulations. Furthermore, together with the requirement to introduce compensation regulations the board of directors must publish a compensation report (*Vergütungsbericht*) confirming compliance with the compensation regulations on an annual basis.

When it comes to shareholder approval requirements, the essence of the existing rules, the Rip-Off Initiative and the counterproposal can be summarised as follows:

Existing rules

No shareholder approval on executive compensation required.

Some listed companies have introduced advisory votes.

Rip-Off Initiative

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).

Severance payments, sign-on bonuses, success-related compensation in connection with purchases or sales of companies, and additional advisor's fees or employee compensation within the group for the benefit of members of the board and management are prohibited.

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.

Criminal sanctions for non-compliance.

Counterproposal

Aggregate compensation of the board of directors and the advisory board (if any) is subject to approval by the shareholders at the annual general meeting. The shareholders' resolution is binding (rather than advisory).

With respect to the base compensation (including fixed and variable components such as a bonus), the shareholders' vote relates to the current fiscal year, whereas with respect to the so-called additional compensation the vote relates to the past fiscal year.

Aggregate compensation of the management must be voted on by the shareholders at the annual general meeting. However, the articles of association must set out whether shareholders' vote shall be binding or advisory.

The board of directors is obliged to produce compensation regulations, which are subject to shareholders' approval. Shareholders holding 0.25% or more of the share capital or voting rights or shares with an aggregate nominal value of CHF 1 million or more are entitled to request amendments of the compensation regulations.

The compensation regulations must, among other things, set forth the principles and elements governing the compensation the members of the board and the management (including criteria for credits, loans, compensation plans, sign-on bonuses, and incentive and participation plans).

Likely outcome of nationwide ballot?

Swiss pundits say that because it could be perceived as anti-business and its proponents lack the necessary financial resources for an effective campaign, the Rip-Off Initiative will probably fail to win popular backing but warn that recurring manager pay scandals could change sentiment. Although many Swiss firms have increased transparency and control over management compensation, shareholder activists such as the Swiss based Ethos Foundation continue to criticize executive pay as excessive.

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