Adjustments to the Swiss Corporate Governance Framework

Urs P. Gnos, Jan H. Hoffmann, and Alexander Nikitine
Walder Wyss Ltd.
Zurich, Switzerland

Introduction

On 3 March 2013, the Swiss electorate voted in favor of the popular initiative “against rip-off salaries”, commonly called “Minder initiative” after its initiator and lawmaker Thomas Minder. As a consequence, Article 95, Paragraph 3, was included in the Federal Constitution.

The provisions in the new Article 95, Paragraph 3 of the Federal Constitution aim at strengthening shareholder rights of listed Swiss stock companies, in particular by introducing an annual shareholder vote on the remuneration of the board of directors and the executive management (“say-on-pay”). In addition, Article 95, Paragraph 3 of the Federal Constitution prohibits certain types of remuneration, e.g., severance payments and advance compensation.

However, none of the provisions establish a cap on remuneration by setting general limitations on the maximum amount a company can pay to the board of directors and the executive management. Except for the ban of certain types of remuneration, the newly introduced changes cover the actual process of the determination of the remuneration. It is no longer in the hands of the board of directors, as it used to be in the past.

The new provisions do not, however, solely relate to aspects around remuneration. Although the driving rationale of the popular initiative was to effectively restrict excessive salaries, Article 95, Paragraph 3 of the Federal Constitution sets forth several mandatory provisions concerning significant corporate governance elements of listed Swiss stock companies, such as a maximum term for the board of directors, the power to elect the chairman and the members of the compensation committee, as well as the duty imposed on pension schemes to exercise their voting rights.
In other words, while originally tailored to curb excessive remuneration, the new provisions include a number of corporate governance rules that have limited direct impact on remuneration but that, overall, adjust the Swiss corporate governance framework in general.

This chapter illustrates the new rules on corporate governance in light of the current Swiss corporate governance framework and addresses how and where the new rules adjust the corporate governance of listed companies incorporated in Switzerland.

Ordinance against Excessive Compensation in Listed Corporations

In General

The newly introduced constitutional provisions are not self-executing and, therefore, require an implementation through federal statutory law, to be enacted by the Swiss parliament. During the current interim period, the Swiss Federal Council (Bundesrat) had to implement the Minder Initiative by means of an ordinance (Verordnung).

For this purpose, on 1 January 2014, the Ordinance against Excessive Compensation in Listed Corporations (the “Ordinance”, Verordnung gegen übermässige Vergütungen bei börsennotierten Aktiengesellschaften, VegüV) was put into force by the Federal Council. Until the Swiss Parliament adopts the final implementing legislation, the Ordinance temporarily governs the subject matter of Article 95, Paragraph 3 of the Federal Constitution.

Although, from a formal point of view, the Ordinance sets the relevant rules only for an interim period, the new rules are likely to shape the standards of the final federal statute. Against this backdrop, Swiss companies that have amended their corporate governance structures pursuant to the Ordinance do not expect to be required to deviate from the core principles arising out of the Ordinance in the near future.

Scope of Application

The Ordinance only applies to Swiss corporations limited by shares pursuant to Articles 620 et seq. of the Code of Obligations to the extent their shares are listed on a stock exchange in Switzerland or

1 Federal Constitution, Article 197, Paragraph 8.
abroad.2 Noteworthy are important distinctions from two other relevant sets of corporate governance rules for listed companies, namely:

1. The Swiss Code of Best Practice for Corporate Governance (the “Swiss Code”),3 and
2. The SIX Directive on Information relating to Corporate Governance (the “Directive”).4

First, the Ordinance applies to Swiss corporations, irrespective of whether the shares are listed on a stock exchange in Switzerland or abroad, while the Swiss Code and the Directive apply only if the shares of the Swiss corporations are listed in Switzerland (and not only abroad). The scope of application of the Ordinance is, therefore, broader than the two other sets of corporate governance rules. Companies listed abroad that have solely transferred their registered seat to Switzerland in the course of a redomestication transaction for tax or other reasons (and, thus, have become Swiss corporations) are subject to the Ordinance.

Second, the Ordinance only applies to Swiss corporations whose shares (and not only bonds or other securities) are listed on a stock exchange. As a consequence, the Ordinance is not applicable to a stock corporation with only equity-based participation certificates (Partizipationsscheine), dividend rights certificates (Genussscheine), bonds, and other debt-based instruments listed.

Third, the application of the Ordinance is not limited to listed Swiss stock corporations but also extends to all pension schemes subject to the Vested Benefits Act of 17 December 1993. The Ordinance imposes certain mandatory duties on such pension schemes with regard to their investments in corporations subject to the Ordinance.5

Say-on-Pay

Votes on Compensation

The most far-reaching novelty introduced by the Ordinance is the mandatory vote of the general meeting (i.e., the shareholders’ meeting

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2 Ordinance, Article 1, Paragraph 1.
3 For an unofficial English translation of the Swiss Code, see http://www.economiesuisse.ch/de/PDF%20Download%20Files/pospap_swiss-code_corp-govern_20080221_en.pdf.
5 Malacrida and Spillmann, Corporate Governance im Interregnum, Gesellschafts- und Kapitalmarktrecht (GesKR) (2013), at pp. 487 et seq.
of the corporation) on the compensation of the board of directors, the executive management, and, if any, the advisory board. Under the Ordinance, all corporations must introduce provisions in their articles of association providing for a binding vote on the compensation of the aforementioned group of persons.\(^6\)

The details and procedure of this say-on-pay framework can be individually defined in the articles of association. However, the framework needs to comply with the following three mandatory requirements:

1. The general meeting’s vote on compensation must be conducted annually;
2. The shareholders’ vote on compensation must be final and binding rather than merely of advisory nature; and
3. The general meeting’s vote on compensation must be held separately for the board of directors, the executive management and the advisory board (if any).

Within these limits, a corporation is free to choose the specific design of its say-on-pay framework. In particular, the articles of association can either provide for the vote covering prospective (future) compensation (e.g., until the next general meeting or for the upcoming business year) or retrospective (past) compensation (e.g., covering the preceding business year).

Combinations of these two periods (prospective and retrospective) and/or a split between different periods of time are feasible too. With regard to the nature of the vote, the articles of association can either provide that the shareholders may submit their own counterproposals to the compensation proposed by the board of directors or limit the shareholders’ right to either approve or deny the proposed compensation.

Furthermore, the articles of association can provide for special rules concerning the course of action in the event that the proposed compensation has been rejected by the general meeting.\(^7\)

The first vote on compensation must be passed no later than at the occasion of the second ordinary general meeting of shareholders after the entry into force of the Ordinance, i.e., in 2015.\(^8\)

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\(^6\) Ordinance, Article 18, Paragraph 1.
\(^7\) Ordinance, Articles 12, Paragraph 2, Number 6, and 18, Paragraph 2.
\(^8\) Ordinance, Article 31, Paragraph 2.
Compensation Report

Pursuant to the Ordinance, the board of directors must issue annually a written compensation report, the contents of which must mainly reflect the detailed information currently required in the annex to the financial statements under statutory law.\(^9\)

The separation of the compensation report from the financial statements became necessary in order to avoid conflicting shareholders’ votes, i.e., between the vote on the approval of the financial statements and the vote on the compensation. Therefore, the separate compensation report is no longer subject to shareholders’ approval but subject to the external auditors’ review. However, the board of directors is free to submit such compensation reports, in particular under a prospective voting regime, to the general meeting for an advisory vote.

Unlawful Compensation

In addition to the mandatory vote of the shareholders on compensation, the Ordinance restricts certain types of compensation to its board of directors, executive management, and advisory board (if any).\(^10\)

In particular, severance payments provided for either contractually or in the articles of association are unlawful. Conversely, payments required to be paid under statutory (Swiss or foreign) law or owed to a leaving executive as a consequence of a judgment or order remain lawful. The Ordinance expressly confirms that payments during a notice period of up to twelve months or fixed-term employment agreements not exceeding twelve months (i.e., payments owed until the end of the contractual relationship) do not constitute prohibited severance payments and are thus not subject to the prohibition.

Furthermore, advance payments in the form of mere upfront payments and incentive fees for the acquisition of other companies by the company are unlawful pursuant to the Ordinance.

Other Corporate Governance Rules

Board of Directors

Pursuant to the Ordinance, the term of office of the members and the chairman of the board of directors ends at the conclusion of the next

\(^9\) Code of Obligations, Article 663b bis; Ordinance, Articles 13 et seq.

\(^10\) Ordinance, Articles 20 et seq.
ordinary general meeting.\textsuperscript{11} Therefore, all members of the board have to stand for re-election every year if they wish to stay on the board of directors.

Terms of office exceeding one year (i.e., longer than until the next ordinary general meeting) are no longer permissible. Furthermore, the members of the board of directors must be elected individually by the general meeting. Finally, the Ordinance requires that the general meeting elect the chairman of the board. Before the enactment of the Ordinance, the chairman was predominantly elected by the incumbent members of the board of directors; shareholders had no say in the respective appointment.

Compensation Committee

The Ordinance requires corporations to establish a compensation committee whose members need to be elected individually by the general meeting.\textsuperscript{12}

The duties and powers of the compensation committee are subject to the articles of association. As for the board of directors in general, the term of office of the members of the compensation committee is limited to one year, subject to re-election. Although compensation committees already exist in many Swiss companies, the members of such committees were typically elected by the board of directors and not by the shareholders.

Independent Proxy Representative

Prior to the Ordinance, Swiss law provided for an institutional representation of shareholders either by corporate proxy (\textit{Organvertretung}), depositary proxy (\textit{Depotstimmrechtsvertretung}), or an independent proxy (\textit{unabhängiger Stimmrechtsvertreter}).

Under the Ordinance, only a representation by the independent proxy is lawful for institutional representation.\textsuperscript{13} Such independent proxy for the representation of shareholders must be elected by the general meeting on an annual basis. The independent proxy must comply with the requirements as provided for the external auditors of the corporation.\textsuperscript{14}

\begin{itemize}
  \item \textsuperscript{11} Ordinance, Articles 3 \textit{et seq.}
  \item \textsuperscript{12} Ordinance, Article 7.
  \item \textsuperscript{13} Ordinance, Articles 8 \textit{et seq.}
  \item \textsuperscript{14} Code of Obligations, Article 728, Paragraphs 2–6.
\end{itemize}
Pension Fund Schemes

Pursuant to Article 22, Paragraph 1, of the Ordinance, pension schemes subject to the Vested Benefits Act are subject to a voting and disclosure obligation with respect to shares held in corporations falling under the scope of the Ordinance. The voting obligation does not apply to all agenda items. The scope is limited to:

1. The election of the board of directors, the chairman of the board of directors, the members of the compensation committee, and the independent proxy;
2. The vote on compensations, as required by the Ordinance; and
3. Votes on certain provision of the articles of association as specified under the Ordinance.

Pension funds may abstain from voting on the above items only if such abstention is in the interest of their beneficiaries. On a yearly basis, pension fund schemes must disclose a summary report addressing compliance with the voting obligation.

If the fund did not vote in accordance with the motions of the board of directors or if it abstained from voting, the pension fund must disclose in such report in detail its voting behavior. In practice, to avoid such costly and time consuming reports, the new rules will have the effect that funds will vote in accordance with the motions of the board of directors, unless overriding interests would dictate otherwise.

Criminal Sanctions

As provided by Article 95, Paragraph 3 of the Federal Constitution, the Ordinance introduces criminal sanctions within the framework of the Ordinance.

Members of the board of directors, the executive management and the advisory board, and the members of the governing body of pension schemes who, against better knowledge, violate certain provisions of the Ordinance are subject to criminal prosecution.\textsuperscript{15}

\textbf{Swiss System of Corporate Governance}

Defining Corporate Governance

Following the common definition of the Report of the Committee on the Financial Aspects of Corporate Governance (the “Cadbury Report”),

\textsuperscript{15} Ordinance, Articles 24 et seq.
corporate governance can be defined as “the system by which companies are directed and controlled”.\textsuperscript{16}

Pursuant to the definition, the essence of any system of corporate governance is that the board is free to drive their companies forward while exercising that freedom within a framework of effective accountability.\textsuperscript{17} The Swiss Code defines corporate governance in a similar way but emphasizes more the alignment of corporate governance to the interests of the shareholders.

Under the definition of the Swiss Code, “corporate governance encompasses the full range of principles directed towards shareholders’ interest in seeking a good balance between direction and control and transparency at the top company level while maintaining decision-making capacity and efficiency”.\textsuperscript{18}

At the heart of corporate governance lies the principal-agent problem. While, in the classical concept of corporations, shareholders have a large amount of residual control, in large, listed companies, there is a separation of ownership and control. In theory, shareholders are the principals and the members of the board of directors their agents, installed by shareholders to direct the company.

However, due to a dispersed ownership structure, the actual degree of control of the principals and economic owners of the company (shareholders) over the direction of the company is limited. The control of the company is, hence, to a large extent, in the hands of the board of directors and not the shareholders.\textsuperscript{19}

At the same time, the self-interest of the members of the board of directors in control of the modern corporation can substantially differ from the interests of the shareholders. Hence, there is a risk that the agents choose to operate in their own interests instead of the interests of the owners of the company, i.e., act to the detriment of the shareholders.

The main purpose of any system of corporate governance is, therefore, to address this principal agent problem by ensuring the required degree of control and accountability of the agents of the company.

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\textsuperscript{19} Berle and Means, \textit{The Modern Corporation and Private Property} (1932).
towards the shareholders. The risk of a misuse of power by the agents can be averted by an effective system of corporate governance. For this purpose, a system of corporate governance needs to strengthen the rights of the shareholders and foster transparency, while at the same time ensuring the efficient direction of the company.

**Rules on Corporate Governance**

**Company Law**

The most fundamental provisions of the corporate governance of Swiss stock corporations are stipulated in the Code of Obligations, which lay out the organizational structure of stock corporations.20

Pursuant to Article 698, Paragraph 1, of the Code of Obligations, the general meeting of shareholders is the supreme governing body of a Swiss stock corporation. In Article 698, Paragraph 2, of the Code of Obligations, the statute provides for a list of inalienable powers of the general meeting of shareholders.

The law confers upon the general meeting in particular the power to adopt and amend the articles of association, to elect the members of the board of directors and the auditors, to approve the management report, the consolidated accounts, and the annual accounts, and to discharge the members of the board of directors.

However, despite the general meeting being designated by law as the supreme power, the board of directors is equally endowed with specific inalienable and non-transferable powers, as enumerated in Article 716a of the Code of Obligations. The law confers upon the board of directors in particular the following duties:

1. The board of directors is responsible for the supreme management of the company, i.e., the ultimate decision-making power in the management of the company may not be transferred to the management and may not be assumed by the general meeting of shareholders;
2. The board of directors possesses overall organizational and financial responsibility;
3. The board of directors is responsible for the appointment and dismissal of persons entrusted with managing and representing the company; and

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20 Bühler, “Regulating Corporate Governance following the ‘Swiss Muesli Recipe’”, Schweizerische Zeitschrift für Wirtschafts- und Finanzmarktrecht (2013), at pp. 141 *et seq.*
(4) The board of directors is responsible for the overall supervision of the persons entrusted with managing the company.

The board of directors can establish committees to which it may delegate specific supportive tasks, but it may not delegate decision-making powers. Furthermore, the articles of association may authorize the board of directors to delegate the management of all or part of the company’s business to individual members or third parties. However, the aforementioned non-transferable duties may not be delegated to the executive management.

Since both the general meeting and the board of directors have specific inalienable powers, their relationship is subject to the so-called “parity principle”. The corporate governance implications of the parity principle are twofold. By defining non-transferable duties, the law ensures that the key management functions of the company remain with the board of directors that is directly legitimated by the shareholders.

At the same time, the parity principle acknowledges that certain functions may not be performed by the general meeting and, hence, must be performed by the board of directors. These functions cannot be transferred to the shareholders because it would impair the effective direction of the company and because shareholders are not subject to any duty of loyalty or duty of care towards the company.

In general, company law sets out a framework of mandatory rules that leaves companies substantial freedom in determining the best corporate governance structure and procedures depending on their specific requirements. However, the law also provides detailed requirements that leave companies no discretion, such as transparency requirements relating to the remuneration.

Swiss Code of Best Practice

While the above-described provisions of corporate law are of mandatory nature, economiesuisse, the Swiss business umbrella organization, has issued legally non-binding recommendations through the Swiss Code.

The purpose of the Swiss Code is, pursuant to its preamble, to set out guidelines and recommendations, but not to force Swiss companies into a straightjacket. Each company must, pursuant to the Swiss Code, retain the possibility of putting its own ideas on structuring and organization into practice. Compliance with the Swiss Code is not a prerequisite for listing on the SIX Swiss Stock Exchange and, in
particular, the Swiss Code is not subject to the “comply or explain” rules of the SIX Swiss Stock Exchange and, hence, is purely soft law.

The recommendations of the Swiss Code follow the provisions of company law and provide companies with guidance on how to construe these provisions with regard to good corporate governance. In particular, the recommendations provide guidance on facilitating the decision making of shareholders, on the composition, structure, and procedures of the board of directors, and on the external auditors. With regard to disclosure, the Swiss Code refers to the Directive on Information relating to Corporate Governance of the SIX.

SIX Directive on Information relating to Corporate Governance

The Swiss Federal Act on Stock Exchanges and Securities Trading requires stock exchanges to regulate the admission of securities for trading. Such listing rules must take internationally recognized standards into account and stipulate that information must be published by listed companies in order to enable the investors to assess the quality of the securities and the issuer.

Based on the statute and in coordination with the working group that published the Swiss Code, on 1 July 2002 (simultaneously with the Swiss Code), the SIX Swiss Exchange enacted the Directive.

In contrast to company law (prior to the enactment of the Ordinance), the Directive sets out detailed disclosure requirements for Swiss publicly traded companies listed on the SIX Swiss Exchange that are deemed to be relevant for the assessment of their corporate governance. Such requirements must be made in an annex to the annual business report. The provisions of the Directive on Information relating to Corporate Governance relate solely to disclosure and do not impose any material corporate governance requirements.

The Directive requires substantial and extensive information on various aspects of listed companies. In particular, the Directive sets out disclosure requirements in respect of the following items:

1. Details on the group structure and significant shareholders;
2. Information on the capital structure;
3. Specific particulars relating to the board of directors and senior management; and
4. Information on shareholders’ participations rights, change of control and defense measures, and audit engagements.
In contrast to the Swiss Code, the Directive is binding for companies incorporated in Switzerland that are listed on the SIX. However, the disclosure requirements by the Directive are subject to the “comply-or-explain principle”. Companies may refrain from certain disclosure if they justify this failure to comply in substantial detail in the annual business report itself.

**New Balance of Corporate Governance through Article 95, Paragraph 4, and the Ordinance**

**In General**

The main purpose of Article 95, Paragraph 3 of the Federal Constitution is to protect the Swiss economy and the ownership of the property of shareholders against excessively remunerated directors and managers of Swiss companies. However, remuneration may not be limited directly, but only indirectly by procedural and structural means within the corporate governance framework of Swiss corporations.

Pursuant to Swiss corporate law, the rules for corporations can be considered a standardized contractual model that, to a large extent, can be adapted to specific needs by shareholders in the articles of association. As set out above, corporate law provides only for the most fundamental mandatory provisions on corporate governance, in particular the parity principle, and contains largely broad provisions leaving companies large discretion. Detailed mandatory provisions on corporate governance are only provided for in certain key areas. Against this backdrop, the implications of Article 95, Paragraph 3 of the Federal Constitution and the Ordinance are twofold:

1. The new provisions shift certain rights from the board of directors to the general meeting. This may reduce the principal agent problem since shareholders as principals have as a result more control over their agents (the board of directors and the executive management). Some of the affected rights, in particular the determination of the remuneration of the executive management, were, until the Ordinance entered into force, inalienable duties of the board of directors. Accordingly, the prevailing parity principle in Swiss corporate law has been adjusted to some extent by the new Ordinance provisions. Furthermore, pursuant to the concept of good corporate governance, powers should only be shifted to the general meeting to such extent that the decision-making capacity and efficiency of the direction of
the company are maintained. It must be determined, therefore, whether such shift of powers to the general meeting is suitable to enhance corporate governance.

(2) Certain provisions do not directly shift powers from the board of directors to shareholders but, instead, provide for prohibition, e.g., the making of severance payments. As such, the rules do not enhance the rights of shareholders but rather limit them (assuming there may well be cases where shareholders would welcome the possibility to provide for such payments, e.g., mere upfront payments to attract potential new managers). Therefore, from a corporate governance perspective, it would be more favorable not to impose prohibitions on the powers of the shareholders but instead to enhance transparency and the procedures for the participation of shareholders. By enhancing the rights of shareholders rather than limiting them, their economic ownership would in fact be better protected as is the purpose of Article 95, Paragraph 3 of the Federal Constitution.

**Maximum Term for Board of Directors and Election of Chairman**

Pursuant to Article 3 of the Ordinance, all members of the board of directors must be elected every year. Previously, Swiss law allowed companies to freely define the term of office in the articles of association.

With regard to the election of the chairman, the law had allowed shareholders to determine in the articles of association whether the chairman was elected by the general meeting or rather by the members of the board of directors itself. Pursuant to Article 4 of the Ordinance, the chairman must be elected by shareholders, and the term of office is limited to one year, subject to re-election.

While the yearly election of members of the board of directors may strengthen their accountability towards shareholders and thus limit the principal-agent problem, there also are arguments against a term of office of only one year:

(1) A mandatory term of office of one year may create the danger that in times of crisis the members of the board are not up for re-election and, therefore, valuable and required knowledge is lost to the company;

(2) A short term of office may induce the members of the board of directors to act under a short-term perspective instead of a longer, more sustainable perspective of success of the company; and
A short term of office may weaken the position of the board of directors as to the executive management. There are valid arguments for terms of office exceeding the period of one year. From the perspective of corporate governance, which should primarily be directed at enhancing shareholders’ interests, a mandatory term of office of one year is not desirable.

Shareholders of a company should be free to determine in the articles of association which term of office is best suited for their company. The same holds true for election of the chairman. While there are good arguments for an election of the chairman by the general meeting, i.e., a higher degree of legitimacy and accountability towards shareholders, there is no need to limit the freedom of shareholders to take a decision on this by themselves.

Corporate governance rules should not limit the rights of shareholders but facilitate their participation in the decision-making of the company and enhance their rights. Therefore, with regard to the new provisions under the Ordinance, it would have been preferable that the general meeting could opt-out from the yearly election by providing for a longer term of office in the articles of association by a qualified majority.

However, it is to be noted that, under the previous law, the members of the board of directors could be withdrawn at any time by the general meeting, and such members could resign at any time. Therefore, the new provisions, although restricting the rights of shareholders in this regard, might not lead to substantial practical consequences.

Remuneration Committee

Previously, the board of directors was free to set up committees. Now, Article 7 of the Ordinance requires every company subject to it to establish a remuneration committee. Members of the committee are to be elected annually by the general meeting from among members of the board of directors. The Ordinance does not provide for conditions for the members of the remuneration committee to be fulfilled, e.g., relating to their independence.

The details of the duties and powers of the compensation committee are subject to the articles of association of the company. In particular, the articles of association can provide that the committee has the power to pass resolutions on issues of remuneration on its own or that it has only preparatory functions.
However, since members of the committee are directly elected by the general meeting, conferring only preparatory duties upon the committee would be in contrast to its increased legitimation. In fact, conferring only preparatory duties upon the committee, pursuant to the prevailing principles of Swiss corporate law, would not require its members to be elected by the general meeting.

With the possibility to confer decision-making powers upon the remuneration committee, the current rule that all non-transferable duties are to be decided by the board of directors is abolished. While most Swiss listed companies under the previous law set up remuneration committees, the final decision-making power always rested with the board of directors at large. As a result of such transfer of decision-making power, the liability of the directors not being members of the remuneration committee should necessarily be limited.

**Independent Proxy**

In public companies without controlling shareholders, the vast majority of shareholders do not exercise voting rights personally but are represented by an institutional proxy.

The provision relating on how such proxies need to be instructed and how such proxies exercise the represented votes, therefore, has an substantial influence on the result of any election and voting of the general meeting.21

Until the Ordinance became law, Swiss statutory law provided for three forms of institutional proxy:

1. Proxy of the company;
2. Proxy of the depositary bank; and
3. Independent proxy.22

Two corporate governance related problems were discussed with regard to representation of shareholders by corporate and depositary proxy.23

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First, concerns with regard to general conflicts of interest of these proxies were raised.

Second, statutory law provided that, if instructions could not be obtained in good time and no general instructions were given, the depositary proxy must vote in favor of the motions proposed by the board of directors. Such rule was applied to all three types of institutional proxies if no instruction was given. In particular, the rule also applied when shareholders signed and returned a proxy without giving further instructions. The rule to vote in favor of the board of directors (in dubio pro administratione) strengthened the position of the board.

In light of these corporate governance concerns, Article 11 of the Ordinance newly provides that the institutional representation of shareholders by corporate proxy or depositary proxy is no longer permissible. The only form of institutional proxy henceforth permissible is representation by an independent proxy. The independent proxy is no longer appointed by the board of directors (except in cases of a vacancy) but must be elected annually by the general meeting. The non-institutional, i.e., individual representation by proxies, is not governed by the Ordinance and remains possible.

The Ordinance requires the board of directors to ensure that shareholders have the possibility to provide instructions for each motion to agenda items contained in the invitation to the general meeting and to provide general instructions for new motions that have not been disclosed in such invitation.24

Although not explicitly provided for in the Ordinance, companies may phrase their proxies in such way that a general instruction (e.g., to vote in favor of motions of the board of directors) is deemed to be given in case the proxy is returned by the shareholder signed but otherwise left blank (deemed instruction).

In the absence of instructions, the independent proxy must, contrary to the previous rule, abstain from voting.25 While abstention from voting in the absence of instructions is preferable to the previous rule to vote in favor of the board of directors, it creates a new distortion. Pursuant to the general rule of Articles 704 and 705 of the Code of Obligations, a vote of the general meeting of shareholders requires the majority of the votes represented to be approved.

Hence, abstention has the same effect as a vote against a motion. However, since, in practice, many proxies that are returned blank

24 Ordinance, Article 9.
25 Ordinance, Article 10, Paragraph 2.
include a deemed instruction (the shareholder does not tick any box), the number of abstentions due to lack of instructions will, in practice, likely be limited.

**Mandatory Voting for Pension Funds**

The Ordinance requires that pension fund schemes subject to the Swiss Vested Benefits Act are obliged to vote their shares in Swiss corporations listed in Switzerland or abroad with respect to certain matters as listed in Article 22 of the Ordinance.

Furthermore, such pension fund schemes must provide insured persons with a summary report of how they complied with such voting duty at least on an annual basis. Pension schemes may abstain from voting if doing so in the interest of the insured persons. However, this exception does not apply on refraining from voting altogether. Hence, pension funds must participate in every general meeting. Members of the governing body of persons entrusted with the management of such pension schemes who against better knowledge do not comply with this voting obligation are subject to criminal prosecution.

Until the Ordinance came into force, shareholders were not required to exercise their shareholder rights. The introduction of a voting obligation is, hence, in fundamental opposition to basic principles of Swiss corporate law.

Besides being in opposition to basic principles of Swiss corporate law, such voting obligation is against the legitimate economic interests of pension fund schemes and their insured persons. In particular for smaller pension funds, the voting obligation may be overly costly. The Ordinance provides that pension schemes must vote in the interest of their insured persons and thus implies that the voting of shares is generally in the interest of the insured persons.

However, this does not generally hold true. The single interest of pension funds and their insured persons is the maximization of the (risk-adjusted) return on their investment. Exercising voting rights is only in their interest if the expected gains in the return on their investment exceed the cost of voting. In particular for non-controlling stakes, the expected gains may be limited.

If the return on the shares of the company is not sufficient, it may, therefore, be more economical to sell the shares than to influence the...

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26 Ordinance, Article 22, Paragraph 3.
27 Ordinance, Article 25.
course of business of the respective company by exercising the voting rights. Furthermore, the Minder Initiative misconceives that the amount of remuneration paid to the board of directors and executive management is only of subordinated interest to insured persons (and shareholders in general) compared to the overall return of the respective company.

As a result, imposing a voting obligation is contrary to the interests of shareholders and weakens their rights instead of enhancing them. Such voting obligation is based on a social and political goal of limiting the remuneration of members of the board of directors and executive management rather than enhancing the rights of shareholders.

Furthermore, from a perspective of corporate governance, the provision that pension schemes must disclose in detail their voting behavior in a report to their insured persons if they did not vote in accordance with the motions of the board of directors (or if they abstained from voting) is questionable. Such provision might unduly influence the decision making in the general meeting since, as mentioned above, it creates incentives for pension fund schemes to vote in favor of the motions of the board of directors. In short, the provisions of the Ordinance relating to pension funds are not suited to enhance the corporate governance of companies incorporated in Switzerland because they are to the detriment of the interests of the insured persons (i.e., the indirect shareholders). However, it is to be noted that only Swiss pension fund schemes are subject to these new provisions.

Conclusion

On 3 March 2013, the Swiss electorate voted in favor of the popular initiative “against rip-off salaries”, commonly called the “Minder initiative”. As a consequence, a new Article 95, Paragraph 3, was included in the Federal Constitution, and the Ordinance was set into force on 1 January 2014. The Ordinance will govern the subject matter of Article 95, Paragraph 3 of the Federal Constitution, until final implementing legislation has been adopted by the Parliament.

The core provisions of Article 95, Paragraph 3 of the Federal Constitution and the Ordinance relate to the process of the determination of the remuneration of the board of directors and the executive

28 Ordinance, Article 23, Paragraph 2.
management and ban certain types of remuneration. The new regulation also provides for several new provisions affecting the Swiss corporate governance framework in general. The following effects of these new provisions on corporate governance are noteworthy.

First, a number of decision-making powers are transferred from the board of directors to the general meeting. Thus, rights of the shareholders are strengthened relative to the board of directors. However, such transfer of decision-making powers may affect the efficient direction of the company and fundamentally adjusts the prevailing parity principle of Swiss company law. From a corporate governance perspective, it is to be noted that shareholders are not subject to any duty of loyalty or duty of care.

Furthermore, since gathering and analyzing all relevant information might be overly costly for individual shareholders, they will increasingly need to rely on external advice in order to exercise their voting rights in the general meeting. Hence, the shift of powers from the board of directors to the shareholders will fundamentally strengthen the influence of shareholder advisory firms (such as ISS and Ethos). This does particularly hold true for pension schemes that are henceforth subject to a voting obligation.

Second, the new rules also weaken the rights of shareholders. While, until recently, Swiss corporate governance regulation largely provided for rules allowing companies to structure their corporate governance framework according to their individual needs, the new provisions of the Ordinance are of binding nature (e.g., regarding the term of office of the members of the board of directors or the prohibition of certain types of compensation).

Theoretically, the Ordinance limits the rights of shareholders rather than enhancing them. Hence, the new binding provisions negatively adjust the current Swiss corporate governance framework. From a practical point of view, however, the actual effects of such new provisions on the corporate governance of Swiss companies will largely remain limited.

Third, the Ordinance imposes a voting duty on Swiss pension fund schemes. The voting duty is in contradiction to the current Swiss company law and corporate governance rules. More importantly, it is inconsistent with the economic interests of the affected shareholders and insured persons. However, as mentioned above, promoting the interests of shareholders should be the primary goal of any corporate governance framework.
Finally, the new rules impose criminal sanctions on members of the board of directors, the executive management, and the advisory boards, as well as the members of the governing body of pension schemes for the violation of various provisions of the Ordinance. Obviously, this is at odds with fundamental corporate governance principles.

The violation of corporate governance provisions should primarily be subject to civil law instruments and civil liability. The agents (i.e., members of the board of directors and executive management) should be primarily controlled by their principals (i.e., shareholders) and not a public prosecutor.

Only in cases of severe breaches of such duties should criminal sanctions apply (as was provided in the corporate governance framework until the Ordinance). However, as the Ordinance requires such violation to be committed “against better knowledge”, the actual cases of criminal prosecution will likely be rare.