Switzerland

Switzerland is on a slippery slope towards overregulation, says Michel Haymann of Haymann & Baldi

Recent developments show a marked proliferation of regulatory provisions. The self-regulatory origins of corporate governance rules mask the fact that what started out as warmly recommended voluntary rules of conduct ended up as mandatory provisions, the enforcement of which was ultimately made the business of regulatory bodies. The emphasis on the self-regulatory character of corporate governance rules has always been guided by the attempt to promote soft law and avoid strict legislation. This has clearly failed. Regulatory provisions relating to corporate governance tend to obscure that, from a legal perspective, principles of corporate governance are part of company law. The enthusiasm with which they are adopted calls for Lord Hampel's warning that it is dangerous to believe that rules and regulations about structure will deliver success (Hampel Report, 1.2). The legislative trends to improve Swiss law in matters of corporate governance concentrate on a revision of company law. This might lead back to the sources and could produce laws rather than codes of best practice.

Three sources of corporate governance rules are distinguished: self-regulatory provisions, stock exchange regulations with an impact on corporate governance, and company law. They are often intertwined. Rules of a self-regulatory nature regularly mushroom where existing company law appears inadequate and demands for strict legislation are encountered. For example, shortcomings in transparency, accountancy and minority protection led to the adoption of the Swiss Code of Best Practice. In the field of public takeover bids, the self-regulatory Swiss Takeover Code was adopted and put into operation to avoid regulatory legislation. It was the predecessor of the corresponding regulatory regime on the same subject matter that is now part of the Swiss Stock Exchange Regulations. The Due Diligence Conventions of the Swiss Bankers Association, the first of which goes back to 1977, and their various revisions with increasingly tighter rules, are the precursors of strict law on money laundering. Self-regulatory regimes invariably resulted in the enactment of strict law on identical subject matters.

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Self-regulating provisions

Swiss Code of Best Practice
The Swiss Code of Best Practice is a voluntary set of rules prepared under the guidance of the Swiss Business Federation and put into effect from July 1 2002. It contains general guidelines on the effective exercise of shareholders' rights, transparency, how a company is run and how to establish a balance between direction, control and transparency at the top company level while maintaining decision-making capacity and efficiency. It underlines the interrelation between corporate governance and the Swiss Stock Exchange and takeover regulations but expressly declares that it cannot, or can only partially, make recommendations in this respect. This sets the benchmark for its practical importance.

Corporate Governance Directive (CGD) of the Swiss Exchange
Put into effect simultaneously with the Code of Best Practice, the CGD contains guidelines for annual reports and the details that they must contain. The details are set out in annexes to the CGD and relate to group structures, shareholders, capital structures, limitation of transferability and nominee registrations. At the core is the section on disclosure of management remuneration schemes, which is limited to the disclosure of global salaries paid to management and members of the board, not itemized by individuals. The highest remuneration must be disclosed on a no-name basis. The CGD is not binding, except for the section that deals with compensation and shareholdings of board members and senior management. These core provisions will be largely superseded by an amendment to company law that will come into force on January 1 2007 (see below).

Directive on the Disclosure of Management Transactions
This directive came into force on July 1 2005 and requires members of a Swiss Exchange-listed issuer's board and senior management to notify the Exchange of transactions involving their own interests. The disclosure obligation is incumbent upon the individual, but the issuer must cause the relevant persons to comply. How such disclosure is enforced is the issuer's problem. The English text is also proof that it is possible to write with a Swiss-German accent.

Due Diligence Convention of the Swiss Bankers Association, 2003
This is a voluntary set of rules adopted by the Swiss Bankers Association supplementing the money laundering legislation that it could not avoid, centring on know-your-client rules.

Wolfsberg Anti-Money Laundering Principles
This is a set of rules of conduct developed and adopted by a group of internationally operating banks in the sector of private banking and clearing under the guidance of UBS and Credit Suisse relating to anti-money-laundering measures for private banking, correspondent banking, mutual funds and other pooled investment vehicles and for the suppression of financing of terrorism.

Stock Exchange Regulations and their impact on governance

Interplay of private law and public law
The Federal Act on Stock Exchanges and Security Trading (Sesta) and its related implementing provisions provide a

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regulatory network that intertwines company and financial law of a private law nature with public and administrative law. The Stock Exchange is a private law association within the meaning of the Swiss Civil Code. Its regulations, according to Article 4 of Sesta, are of a regulatory nature, but subject to approval by the Supervisory Authority that is the Federal Banking Commission. So the Stock Exchange Regulations are labelled as self-regulatory, subject to the ultimate regulatory control of the Federal Banking Commission. Where the Commission's controlling powers do not reach, the Stock Exchange has self-regulatory powers that it enforces towards its members. The areas relating to issues of corporate governance include the protection of minority shareholders, primarily under the aspect of investment protection and in the context of a takeover situation.

Minority shareholder protection

The mandatory Stock Exchange Regulations are designed to warrant transparency of the market and the protection of minority shareholders as members and investors. Among those relevant for issues of corporate governance, they comprise disclosure duties on shareholdings upon transgression of certain thresholds expressed in percentages of the voting rights (5%, 10%, 20%, 33.3%, 50% or 66.6%). Reaching the threshold of 33.3% triggers a mandatory obligation to make a bid for all the relevant issuer's listed stock. The rules governing the bidding process serve transparency and equal treatment of shareholders. In this context, once an offer is announced, the board may not take any defensive measures that would affect the assets and liabilities of the issuer to fence off a bid. It must prepare a report with recommendations whether to accept or reject the offer and indicate what defensive measures are intended and what decisions in respect of defence measures were taken (if any) by the shareholders' general meeting before or after publication of the offer. So the prohibition to take defence measures in a takeover situation can be reversed by an extraordinary shareholders' meeting. This provision of the Sesta shifts the ultimate responsibility for defence measures onto the shareholder's general meeting: company law overrides regulatory restrictions. The question is whether these rules can realistically be applied in light of the exceptions in the regulatory framework:

Exceptions that make a difference: opting-out, opting-in, opting-up: Potential target companies could exclude the obligation of an offeror to make a compulsory takeover bid by providing accordingly in their articles of association before the Sesta came into force on January 1 1998 and before being listed. A number of issuers have done so. Any issuer may opt-up by providing in its articles of association that the relevant threshold be raised to 49% before being listed. The issuer that has opted-out may choose to opt-in again by reintroducing the obligation for a potential offeror to make a mandatory bid. This has been used as a tool to fence off minority interests with controlling powers.

Defence measures: The Stock Exchange Regulations contain a list of unlawful defence measures that the board may not adopt after a takeover offer is published. This imposes serious limitations on the board's discretion in the exercise of its powers as a supreme body of the company by way of public law prohibitions. These are not necessarily effective because the prohibition to adopt defence measures only takes effect from the date an offer is published and does not apply where an offeror makes an advance notification to the Stock Exchange as the law permits. The limitations relating to defence measures imposed upon the board may be superseded by a decision of an extraordinary general meeting of the shareholders. In practice, by the time it is convened, it might be too late. A decision of the extraordinary general meeting to set aside legal limitations imposed on the board in respect of defence measures depends on what votes can be mobilized. This raises the issue of dormant shareholders' rights.

Dormant shareholders' rights: These rights relate to either so-called Dispo shares or to depositary shares. Dispo shares in Swiss parlance are shares purchased through the banking system for which the beneficial owner has not filed a request for registration as a shareholder to the company. These shares do not vote at all, but they play a role for issues of quorum. Depositary shares are registered shares endorsed in blank or bearer shares held by banks or other financial institutions in custody for their clients, for which they hold standard powers of attorney developed by the banks for their representation in the general meeting of shareholders. The standard powers of attorney used usually reflect the gist of the law on the subject. This template provides that, in the absence of instructions, the proxy will vote in favour of the motions of the board of directors. The big exception is that the bank may, but need not, exercise the voting rights under the proxy. The licence to abstain from voting by a bank that controls more dormant voting rights than individuals normally do is problematic – mass abstinence may be a tool for the exercise of power. A bank may act or fail to act as a proxy and act differently for the representation of Nostro share positions or shares of selected depositors for which it holds discretionary powers for asset management. The potential for conflicts of interest is manifest, and it is enhanced by the fact that banks are security dealers within the meaning of the Stock Exchange Regulations. In this quality,

they have special fiduciary duties towards their clients. They must ascertain that no conflicts of interest develop to the clients' disadvantage. This obligation exists as a rule of conduct of a regulatory nature applicable to security dealers. However, the Sesta does not expressly provide the civil law consequences of a violation of these fiduciary duties.

These examples illustrate that, in an acute phase of a takeover situation, only the board can take effective defensive measures. To ascertain that the board pursues the interests of the shareholders and not its own, it should face the risk of being held liable by the shareholders. The regulatory framework of the Sesta does not address this issue. Company law as it stands today does not offer enough protection. This suggests that the law on listed companies should become part of the body of company law. Shareholders' protection should primarily rest on private law. The Swiss government's legislative projects point in this direction.

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Company law

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Transparency regarding remuneration

Swiss company law was amended on October 7 2005 by adopting rules providing that companies limited by shares must disclose, in the attachment to the yearly financial statements, remunerations schemes and credit facilities granted to members of the board or senior management. Disclosure must comprise the total amount of remuneration and credits granted to the recipients, and be itemized by individual recipient (identified by name for members of the board and of the advisory council, if any). Disclosure is limited to the total amount paid to senior management and must only be itemized in respect of the highest amount, naming the recipient. The fact that the CGD did not require identification by names was obviously considered an insufficient contribution to transparency by the legislator. The new regime will come into force on January 1 2007.

Revised accountancy and audit rules

A big improvement in terms of corporate governance is expected from the enactment of revised audit rules coupled with the adoption of the Law on the Admission and Supervision of Auditors on December 16 2005, which should be put into force in the second half of 2007. The new legislation is an offshoot of the original plan to create a separate law on accountancy and audit. It was divided into two projects to give audit rules priority. The first partial project deals with the obligation of commercial companies to proceed to an audit of their financial statements and the obligation to maintain an internal audit body. It is coupled with the introduction of the Law Regulating Admission and Supervision of Auditors. The rules on audit have been incorporated into company law and comprise an amendment to the Swiss Code of Obligations. The far-reaching revision of accountancy rules is the second part of the project and has been deferred. It is part of the general revision of company law (see below). The revision encompasses all types of private companies, with a special emphasis on the needs of small and medium-sized enterprises. In respect of publicly listed companies, the audit primarily aims to protect investors. The provisions are entirely incorporated into the part of the Swiss Code of Obligations dealing with company law.

Law on Companies Limited by Shares revised

In early December 2005, a preliminary government draft was circulated for comments on a general revision of company law relating to companies limited by shares. It is the second large revision of the law on companies limited by shares, the first being that of 1991. The emphasis of the preliminary draft is on improvement of aspects of corporate governance and, with the same focus, on a revision of accountancy rules. The emphasis of the preliminary draft is on disclosure of remuneration to organs of all commercial companies, reinforcement of shareholders' rights, public access to relevant information through the Registry of Companies, institutional representation of shares and an improvement of the rules on the role of the board. In respect of accountancy, stricter rules will apply to large companies as defined by the law. Financial statements and valuation provisions will be modelled on IFRS rather than on European standards. Consolidated accounting must follow the patterns of acknowledged standards such as IFRS, US Gaap or Swiss Gaap FER. The project is in its preliminary stages. The last revision of 1991 spilled over a quarter of a century, so hopes for a swift adoption are mitigated by past experience. Time, as always, will tell.

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