Swiss Corporate Law Reform: Transfer of the provisions on compensation in listed stock corporations to the Swiss Code of Obligations

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This legal update is part of a series summarizing the most important upcoming amendments to Swiss corporate law in a condensed form as relevant for legal practitioners. Previously published legal updates can be found on our website at Swiss Corporate Law Reform 2020. New legal updates on the corporate law reform are regularly e-mailed to our newsletter subscribers and published on our website.

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Key takeaways

As part of the Swiss Corporate Law Reform, the provisions on compensation in listed stock corporations will be transferred to the Swiss Code of Obligations. In particular, the following amendments will enter into force:

- **The compensation report must now disclose participation rights and options on such rights, external mandates, and the reasons for and measures taken in connection with the gender quotas.**
- **In contrast, the compensation report no longer has to disclose compensation to former members that is not in line with market practice, unless such compensation relates to a past activity for a corporate body.**
- **The compensation report also no longer has to include the total supplementary compensation amount paid to the senior management as well as the amount paid to each member.**
- **In the case of a prospective vote on variable compensation, the compensation report must now be submitted retrospectively to the general meeting for an advisory vote.**
- **The catalogue of impermissible compensation is extended to former members and to related persons; in the case of compensation within the group, only to related persons.**
- **No longer permitted is compensation for non-compete clauses if the non-compete is not commercially justified or exceeds a certain amount, as well as compensation in connection with a past activity for a corporate body that is not in line with market practice and replacement awards that do not compensate a demonstrated financial disadvantage.**

Introduction

On 19 June 2020, Swiss Parliament adopted the final text of the Swiss Corporate Law Reform, which also includes the incorporation of the provisions on compensation in listed stock corporations into the Swiss Code of Obligations (CO). These provisions are currently contained in the Ordinance against Excessive Compensation in Listed Stock Corporations (VegüV/OaEC). The provisions have largely been retained, but in some cases amended or clarified. A few new regulations have been added. The entry into force of the entire revision of corporate law is not expected until 2023 according to current estimates by the Federal Office of Justice. An exception to this is the provision concerning gender quotas, which already entered into force on 1 January 2021.

Scope of application

In accordance with current Swiss corporate law, the compensation provisions apply with mandatory effect to listed stock corporations. The stock corporations must be incorporated under Swiss law and must have their registered office in Switzerland. Additionally, their shares must be listed (in part or in full) on a Swiss or foreign stock exchange.

The Corporate Law Reform, however, provides that non-listed stock corporations may stipulate in their articles of association that the compensation provisions apply to them in part or in full. The consequences thereof are solely a civil law matter; impermissible compensation would have to be reimbursed and breaches of duty by the board of directors could be enforced by means of a liability action. Opting-in does not entail any consequences under criminal law.

Content of the compensation report

Disclosure of participation rights and options on such rights

The participation rights in the company and the options on such rights of the members of the board of directors, the senior management and the advisory board as well as of persons related to the members (related persons) are no longer to be disclosed in the notes to the financial statements, but in the compensation report. The disclosure obligation requires the reporting entity to provide the names and functions of those current members who hold participations or conversion/option rights in the company. The names and functions of related persons holding participations or conversion/option rights do not have to be disclosed, rather the name and function of the respective member to whom they are related. By disclosing the control relationships of a company to the shareholders, transparency is to be increased and possible conflicts of interest mitigated.

Disclosure of external mandates

As under current law, the articles of association have to state how many activities the members of the board of directors, the senior management and now even the advisory board may perform in comparable functions at other companies with commercial objectives. The revised law provides that in addition to stating the permissible number of such mandates in the articles of association, the external mandates themselves must be disclosed in the compensation report. This should enable shareholders to recognise any conflicts of interest and to estimate the time commitment of the individual members. Furthermore, transparency regarding external mandates enables the general meeting to assess vis-à-vis the shareholders whether it would like to limit the number of permissible activities by adjusting the statutory basis.

External mandates, however, only have to be disclosed if two cumulative prerequisites are met. On the one hand, the activity at a third-party company must be performed in a comparable function to that of member of the board of directors, senior management or advisory board. On the other hand, only activities in companies with commercial objectives must be declared. Thus, activities in non-profit organisations and trusts are excluded. Activities in domestic and foreign parent companies and subsidiaries must, however, also be disclosed.

The scope of information includes the first and last name of the member, the name and firm of the third-party company and the function performed.

Statement of reasons and measures in the event of non-compliance with gender quotas

The compensation provisions also introduce the regulation regarding gender quotas, which already entered into force on 1 January 2021. In this regard, we refer to our first Legal Update of this series of the Swiss Corporate Law Revision.

No general disclosure of compensation to former members that is not in line with market practice

Currently, Swiss corporate law provides for disclosure in the compensation report of any compensation that the company paid directly or indirectly to former members of the board of directors, the senior management and the advisory board to the extent that (i) such compensation is related to the past activity for a corporate body of the company or (ii) such compensation is not in line with market practice.

The new provisions in the Swiss Code of Obligations (nCO) remove the second alternative (see Article 734a para. 1 no. 4 nCO). Therefore, compensation to former members that is not in line with market practice must only be disclosed if it is related to the past activity for a corporate body.

Non-disclosure of the total supplementary compensation amount and the amount paid to each member

The scope of the information to be disclosed in respect of compensation remains largely unchanged.

However, there are simplifications for companies that provide in their articles of association for a supplementary amount of compensation for members of the senior management in the event the general meeting has voted on the compensation of the senior management on a prospective basis and new members of the senior management are appointed after such a vote.

Only the names and functions of the members of the senior management to whom supplementary compensation amounts were paid must now be disclosed. No longer to be disclosed under the new Swiss corporate law is the total supplementary compensation amount for the senior management as well as the amount paid to each member.

Voting on compensation

Retrospective advisory vote in case of prospective vote on variable compensation

As under current Swiss corporate law, the general meeting must vote annually on the compensation of the members of the board of directors, the senior management and the advisory board. The regulation of the particulars of the vote remains subject to the articles of association. The company is free to vote on the respective compensation retrospectively or prospectively.

If a company votes on variable compensation prospectively, the board of directors must under the revised corporate law submit the annual compensation report to the general meeting in the following year for a retrospective advisory vote. This mechanism is already in line with best practice, but is now mandatory. Since the particulars of the vote on compensation must be determined in the articles of association, this amendment requires an adjustment of the articles of association for certain companies.

The retrospective advisory vote is intended to strengthen shareholder participation. It further serves as an instrument of dialogue and as a warning indicator for the board of directors. If the compensation report is rejected by the general meeting, this indicates to the board of directors the need to adjust the compensation system with regard to future compensation.

Supplementary compensation amount only for new members of the senior management

As is already the case under current Swiss corporate law, in the event that the general meeting votes on the compensation of the senior management on a prospective basis, the articles of association may provide for an additional amount for the compensation of senior management members who are appointed between two general meetings. The wording of the new Article 735a para. 1 nCO clarifies that the additional compensation amount may only be used for those members who were not previously part of the senior management, i.e. not for those who were promoted within the senior management.

Term of contractual relationships

The provision according to which the term or notice period of agreements on which compensation is based may not exceed one year now applies not only to compensation agreements with members of the senior management, but also to those with members of the advisory board. The maximum term of compensation agreements for members of the board of directors is no longer based on the term of one year. Rather, the law stipulates that the term of office may not be exceeded. This regulation corresponds to the interpretation of the current provision of the OaEC. The wording does not distinguish between fixed term and indefinite term agreements. However, the term of indefinite agreements can exceed the term of office, provided the agreement is subject to re-election or provides for a right of termination at the end of the term of office.

Impermissible compensation

Extension of the catalogue of impermissible compensation to former members and related persons

As under current law, the compensation provisions include a catalogue of compensation types that are completely prohibited or only permissible under certain conditions. Previously, only the members of the board of directors, the senior management and the advisory board were included as recipients of such impermissible compensation. The catalogue now explicitly mentions former members and also extends to related persons. In addition, impermissible compensation within the group is likewise extended to include related persons.

These amendments require adjustment of the articles of association for the following compensation, which is impermissible without a statutory basis:

- Loans, credits, post-retirement benefits beyond occupational pensions and performance-based compensation to former members or related persons
- Granting of equity securities, conversion rights and option rights to former members or related persons
- Compensation paid to related persons for activities in companies that are controlled by the company

Compensation for non-compete clauses, compensation that is not in line with market practice and replacement awards as impermissible compensation

The catalogue of impermissible compensation is extended by three points. Firstly, compensation for non-compete clauses is now explicitly qualified as impermissible compensation under two alternative prerequisites. If a non-compete clause is not justified by business reasons, compensation based on it is not permissible. If the non-compete clause is commercially justified, compensation based on the non-compete clause that exceeds the average compensation of the last three years is impermissible. The purpose of this extension is to create legal certainty in the distinction between permissible compensation for non-compete clauses and impermissible severance compensation.

In addition, compensation related to the past activity for a corporate body of the company that is not in line with market practice is now impermissible. This general clause is intended to ensure that the prohibition of severance compensation already existing under the current Swiss corporate law and the new provisions on compensation for non-compete clauses are not undermined.

Furthermore, the catalogue of impermissible compensation is extended to include replacement awards that do not compensate a demonstrable financial disadvantage. The purpose of this amendment is, on the one hand, to create legal certainty by clarifying that replacement awards per se are permissible. On the other hand, so-called sign-on bonuses are to be prohibited. These are lump-sum payments that are awarded to persons exclusively for binding themselves to the new employer and at the same time rejecting other potential offers.

Finally, with regard to commissions for the acquisition or transfer of companies or parts thereof, the removal of the second part of the provision, “by the company or companies directly or indirectly controlled by the company”, clarifies that these are not only impermissible for intra-group transactions, but also for extra-group transactions. This is controversial under current law.

Enactment and need for action

Following the enactment of the new law, which, according to current information, is scheduled for 2023 at the earliest, Swiss companies will have a transitional period of two years to amend their articles of association and regulations. However, the board of directors, the management or the in-house legal team should examine the amendments well in advance in order to clarify, firstly, whether the company pays compensation that is already impermissible once the new Swiss corporate law comes into force and, secondly, whether amendments need to be made to the articles of association.

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No legal or tax advice

This legal update provides a high-level overview and does not claim to be comprehensive. It does not represent legal or tax advice. If you have any questions relating to this legal update or would like to have advice concerning your particular circumstances, please get in touch with your contact at Pestalozzi Attorneys at Law Ltd. or one of the contact persons mentioned in this legal update.

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