Bär & Karrer Briefing
20 November 2013

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Minder Rules in their Final Form Published Today

Today, the Federal Counsel has published the final rules (the "Ordinance") implementing the new Art. 95 III of the Swiss Constitution (the so-called "Minder Amendment", also known as the "Rip-Off Initiative"). While the approach of the initial draft of the Ordinance of 14 June 2013 (the "Draft") has been largely maintained, several important changes are to be noted.

At a Glance

Our initial assessment of the changes made in the Ordinance compared to the Draft is positive even though we believe that in an ideal world, the Minder Amendment would have been interpreted in a more business friendly manner that would have kept Switzerland attractive for future relocations of listed companies. Key positive elements are a clearly reduced risk for board members to become entangled in criminal investigations, more time for the introduction of the new rules and a more practical approach if the chairman, members of the remuneration committee or the independent proxy withdraw from their office during the year. A number of clarifications make the lives of compensation committee members easier and more predictable. Amongst the negatives, we highlight the relatively short termination (and contract) periods that Swiss companies and their top managers will have to live with in the future.

We have always believed in the advantages of the prospective binding say-on-pay-vote to attract and retain talent and find comfort for this approach in the Ordinance: The old default solution of the Draft which included a retrospective binding vote on variable pay has gone – and having a prospective vote has an explicit advantage under the Ordinance in terms of hiring new top management because the "reserve" for pay for new managers (which is exempt from shareholders' approval) is only available if the company chooses a prospective vote.

Key Changes Compared to June Draft

Transitional Rules Relaxed...

… but probably still advisable to adapt the Articles of Association ("Articles") at the AGM 2014 (Ordinance allows AGM 2015). The transitional rules contain the following changes to the Draft:

- Clarification that compensation report only needs to be prepared with respect to the business year 2014;
- Amendment of existing employment agreements only required by 1 January 2016;
- First binding say on pay vote only at AGM 2015;
- The explanatory report (the "Report") that was published together with the Ordinance suggests that compensation requiring a basis in the Articles (bonuses, options, shares etc.) or other benefits requiring the same (loans) may still be paid out after 1 January 2014 until the Articles have been amended;
- However, as provided by the draft, the AGM 2014 will have to elect, for a one-year term, all board and compensation committee members and the chairman.

No Default Rule on Compensation Anymore…

… but Articles will have to set the system the company chooses and can, e.g., provide for a fully prospective vote or a retrospective vote on the short term cash bonus only. If so desired, companies may also elect that their shareholders can vote on shareholders' proposals; however, they are still allowed to limit the vote to an approval of the board proposal. The Report suggests that the system must be described clearly in the Articles.

Scope of Criminal Law Is Reduced…

… and thus the risk for members of the board and management to be criminalized has been significantly lowered. This includes in particular:

- No criminal sanctions if more is paid out than the aggregate amount approved by shareholders (there may be civil sanctions in such case, however, such as potential personal liability of those responsible for the payout);
- No criminal sanctions in case of a payout of cash bonus, equity participation rights (shares, options), loans and credits, and retirement benefits without a basis in the articles;
- *Scienter* requirement ("*wider besseres Wissen*") for criminal sanctions (but it is still doubtful whether such requirement will really help in case where merely the legal qualification of a payment is unclear);
- A prison sentence is not mandatory anymore except for the "core" per se prohibitions (i.e., prohibition of severance payments, advance payments, premiums for the acquisition or disposal of a business);
- Clearer and – in most cases narrower – definitions of "core" per se prohibitions (see below).

Employee Agreements limited to 12 months:

- Maximum termination period for top management (important because compensation payments would remain possible during this period without creating problems under the prohibition to pay severance): 12 months;
- Fixed term employment agreements only for 12 months.

Selected Further Changes

Helpful Clarifications and Easing of Rules:

- No need to elect a substitute chairman/vice chairman by shareholders should he/she not complete a full year in office; instead, the board can appoint a substitute until the next general meeting. The same applies for members of the compensation committee and the independent proxy;
- Indemnification payments which are paid to a new hire to compensate him/her for losses suffered with the former employer (e.g. loss of non-vested shares) are now clearly permitted;
- Severance payments which are required by law are not prohibited (important for severances required under non-Swiss jurisdictions in particular);
- Transaction bonuses may be paid out for the management of the target (unless qualifying as a severance payment) since they are only prohibited in relation to acquisitions or disposals of businesses by the company (but not the sale of shares by its shareholders);
- Occupational pension schemes (*berufliche Vorsorge*) have not to be included as retirement benefits in the Articles;
- Closed-end funds (and similar companies) are allowed to transfer their asset management to a legal entity;
- Articles must only contain principles of duties and responsibilities of compensation committee;
- Payments due under an employment contract regardless of termination are not deemed a severance payment even during garden-leave;
- Independent proxy cannot be removed from office with immediate effect but only with effect after the general meeting;

- Report clarifies that qualified electronic signature is not required for electronic proxies to independent proxy;
- Electronic proxies to independent proxy also replace current proxy requirements for bearer shares;
- Public-interest-companies (Art. 762 CO) which have a special status despite of their listing (some utilities and banks) are now partially exempt from the Ordinance with regard to the right of the State to appoint board members.

New Restrictions:

- The Report clarifies that it is not possible to provide that compensation levels approved in former years survive if no new decision is validly taken;
- The extra amount for new hires (for which no shareholders' approval is required if so contained in the Articles) is only possible in case the Articles provide a prospective vote, and may only be used for payments until the next AGM. In addition, the compensation report must disclose in detail how the extra amount was actually used;
- It is clarified that the limitation requirement in the Articles on mandates of members of the board of directors and of the executive board also applies in respect to non-Swiss entities. This change was expected.

New Title

A more neutral title of the Ordinance has been chosen and the reference to "rip-off" (as included in the German version of the Draft) has been removed: It is now called the "Ordinance against excessive compensation in listed companies" (*Verordnung gegen übermässige Vergütungen bei börsenkotierten Gesellschaften, Ordonnance contre les rémunérations abusives dans les sociétés anonymes cotées en bourse*).

A Few High- (or Low-)lights

Binding Say on Pay

As mentioned, the Ordinance will not contain any default solution for the say on pay vote, but leaves it up to the Articles to define how the binding vote will be carried out in a company. We currently see in the market two systems being considered:

- A binding prospective vote (sometimes referred to as a "budget") in which shareholders are asked to approve, typically for the next full business year, a maximum pay for top management. The thinking of most companies considering this solution is to communicate to shareholders the likely base salary in that year (normally starting from current pay levels, adding some room for adjustments due to more seniority or inflation) and then – referring to caps for the short and long term incentives stipulated in the Articles – calculate from that the maximum payout if everything goes perfect. The board or the compensation committee will then have to assess, based on the business performance in that year, how much of this budget will be used. This system has the big advantage that management can be incentivized in a binding manner, both sides knowing how much is paid if objectives are achieved. The downside is that shareholders have to agree in advance to a potentially big payout. In order to mitigate this problem, some companies consider – in line with the current practice of many Swiss companies as well as with international standards – adding to the binding prospective vote a later consultation vote on the compensation report so that shareholders can express a view whether the board made reasonable use of the budget;
- A retrospective vote on either the entire variable pay (typically consisting of a short and long term incentive) or then only on the short term cash bonus. The downside of this approach is that shareholders may eventually deny payment of a bonus even though management has achieved targets. The upside is that numbers submitted to shareholders will overall be smaller, especially after bad years when only a small portion of the maximum allocation or pay is actually the topic of a discussion with shareholders.

We have generally favored the first approach, at least in systems where clear targets are set to achieve a bonus (by the way believing that these targets do not have to be communicated to shareholders up front, when the budget is decided on). The Ordinance now contains a provision which favors this approach, as a separate budget for new hires is held to be valid only in case this system is chosen. Note that the Ordinance is not clear on what applies if certain compensation elements are voted on prospectively and others retrospectively.

Dealing with Transitional Rules

While the new transitional rules allow to adjust the Articles only in the AGM 2015, we believe, in this first reading, that Swiss listed companies should still consider to propose to their shareholders to change the Articles in the AGM 2014 already. This would have a few advantages:

- The Articles generally will, at least in the drafts we have so far seen, try to clarify certain grey areas which arise because the reach of the prohibition to pay severance is unclear. Having certain definitions in the Articles will be helpful as certain payouts which were not previously contractually agreed upon could qualify as severance already in 2014 or 2015;
- The Articles, if adopted in the AGM 2014 will provide a solid set of rules on the conduct for the AGM 2015, including on such issues as electronic proxies. Having said this, the Ordinance specifically provides that the board of directors can issue rules if no change is made in 2014;
- In some instances, it might be considered separating the introduction of the new rules, e.g. describing the principles of the bonus plans in 2014 and start with a prospective vote at the AGM 2015;
- Last but not least, companies have time to adapt should their shareholders not like the proposals submitted in 2014 and can re-introduce them at the AGM 2015.

It still remains somewhat uncertain whether contractual arrangements with top managers which e.g. provide for a severance payment, would allow such payments if they are triggered in 2014 or 2015. Our reading of the Ordinance is that such payments remain possible because the contracts have to be adapted in 2015 only; this suggests that claims under a contract (at least if agreed *bona fide* and not only now with the aim to circumvent the rules), will remain valid. Of course, boards of directors will have to carefully consider how employment agreements providing for payments which will be prohibited can be changed. In relation to Swiss law governed contracts, we believe that such clauses become void even without any action (and the remaining contract will continue to be in force unless the employee may successfully assert that he/she would not have entered into the agreement without the relevant clause).

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