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corporate governance in switzerland

Final Report of the Panel of Experts on Corporate Governance

Swiss Business Federation
Verband der Schweizer Unternehmen
Fédération des entreprises suisses
Federazione delle imprese svizzere

Preface

This report is the outcome of intensive discussions in the Panel of Experts on Corporate Governance[1] and in particular in its committee. The members of the committee were: Prof. Peter Böckli, Thomas Hodler, J.S.D., Richard Meier, Ph.D., Christian Stiefel, and the author of this report, Prof. Dr. Karl Hofstetter. Thomas Pletscher took part in some of the deliberations. The panel of experts had two goals:

1. To describe the legal and actual parameters of corporate governance for listed companies in Switzerland.

2. Where appropriate, to draw up best practice recommendations on corporate governance.

As the work proceeded, it soon became apparent that the national and international market environment had created the need for a study of the existing situation of corporate governance in Switzerland and action for the adoption of best practice recommendations that take account of the special circumstances of the Swiss corporate landscape. This led to the drafting by Prof. Peter Böckli of the "Swiss Code of Best Practice" which was intensively discussed and revised in the Committee and Panel of Experts. This code was the subject of a consultation procedure in the autumn of 2001. The Swiss Exchange (SWX) for its part decided to adopt a transparency directive on corporate governance and to arrange a wide-ranging hearing both on that document and on the proposed "Swiss Code of Best Practice". The present report was an analysis paper to accompany these efforts. The principal outcomes of the consultation procedure and the final texts of the "Swiss Code of Best Practice" and of the "Directive on Information on corporate governance" of the Swiss Exchange are set out in attachments.[2]

The original report was written in German and translated into English by economiesuisse.

Zurich, July 1, 2002

1 The panel of experts included representatives of companies, the legal sector and various organisations; see Attachment IV.

2 See Attachments I–III.

Contents

1 General

1.1 The challenge of international benchmarks

Of late, Swiss companies have been confronted not just by the media and financial analysts, but increasingly also by institutional investors at home and abroad, with issues of corporate governance. The USA and the UK have frequently been taken as benchmarks.

In the USA the discussion of corporate governance became particularly lively in the 1980s and 1990s. This debate was triggered, in particular, by a proposal by the American Law Institute.[3] The Securities and Exchange Commission ("SEC") and the New York Stock Exchange ("NYSE") also took up the matter, leading ultimately to the "Blue Ribbon Report" on the independence of the audit function and on the audit committee. However, no actual corporate governance guideline exists in the USA in the sense of an official or unofficial summary of best practices.[4]

Great Britain took a different route. It all began with the "Cadbury Report" of 1992, which was later supplemented by the "Greenbury Report", the "Hampel Report" and finally the "Combined Code" of 1998. In September 1999 a report on "Internal Control", known as the "Turnbull Report", was drafted. Companies which are listed on the London Stock Exchange must report on their compliance with the "Combined Code" in their annual report. The "comply or explain" principle applies.

The Anglo-Saxon trend spread to other countries and led e.g. to the "Viénot Report" of 1995 in France and to the adoption of corporate governance principles of the OECD in 1999. Finally it also influenced events in Germany, primarily in the framework of the law on control and transparency in corporate matters of 1998 (KonTraG) and later with the adoption of corporate governance principles by the Federation of German industry, the Berlin Initiative Group and more recently the Government Commission on the "German corporate governance Code".[5]

Given the undisputed leadership role played by American developments and, since publication of the "Cadbury Report", also by the debate in the UK on corporate governance, it seems appropriate to make repeated reference in this paper to these Anglo-Saxon benchmarks.

3 See American Law Institute, Principles of corporate governance: Analysis and Recommendations, Volumes 1 and 2, Washington DC, May 13, 1992.

4 On the other hand, certain companies have adopted corporate governance directives, such as the "General Motors Board of Directors corporate governance Guidelines". In the wake of the Enron-affair and others, new corporate governance rules have been proposed by NYSE on June 6, 2002.

5 See draft "Deutscher Corporate-Governance-Kodex" of December 17, 2001.

1.2 Perspective of the report

We assume that in the future financial analysts and investors will attach far more importance to corporate governance than in the past. This report is therefore based on the conviction that corporate governance is relevant to companies ("corporate governance matters!") and also represents a competitive factor for the Swiss exchange and capital market.

However, the report is also founded on the conviction that the discussion of corporate governance must not have two particular outcomes:

1. Uncritical acceptance of Anglo-Saxon or other international standards;
2. Limitation of the organisational freedom of companies under the banner of corporate governance principles interpreted in a dogmatic manner.

Let us not forget that a departure from international standards can also bring competitive advantages. On the other hand, limitations of corporate freedom might spell an end to competitive advantages. This report is therefore typified by an attitude of critical openness in relation to corporate governance. Its perspective is functional and it does not primarily pursue ethical ends.

2 Fundamentals of corporate governance

2.1 Definition of corporate governance

The corporate governance debate, which reached Europe from the USA, has at its core the "agency" problem. This divergence, diagnosed by Berle and Means in the 1930s, between the interests of shareholders ("principals") and the company management ("agents") assumes that the former, because they cannot themselves manage the company, are always at risk of being neglected by self-seeking company managements. This calls for adequate controlling and management structures of listed companies to protect the legitimate interests of shareholders. The main issue is to safeguard the incentive for shareholders to invest in equity capital.

Corporate governance in the broader sense of the term consequently covers all organisational and structural aspects of companies, which directly or indirectly protect the position of shareholders. Understood in that way, corporate governance also involves issues of shareholders rights, including the capital structure, the general meeting and the right to sue in court. Corporate governance in the broader sense therefore comprises all the principles and rules that are designed to ensure the functional effectiveness of a business in order to optimise shareholders' interests ("shareholder value").[6]

Corporate governance is, however, often understood in a narrower sense. In this interpretation it comprises matters of organisation of the highest management bodies of companies and their control, i.e. essentially matters of appropriate "checks and balances" and transparency.[7]

This report does not seek to establish a conclusive definition of the concept of corporate governance. It is guided in the first instance by demands and criticisms with which Swiss companies and the Swiss stock market are repeatedly confronted. The range of topics considered therefore corresponds essentially to the broader concept of corporate governance. On the other hand, a Code of Best Practice can focus on corporate governance matters in the narrow sense of the term. That is done for instance by the English "Combined Code".

6 Monks/Minow, corporate governance, Malden (US)/Oxford (GB), 1995, adopt an even broader definition; they describe corporate governance as "the relationship among various participants in determining the direction and performance of corporations".

7 The "Cadbury Report" (2.5) contains this definition: "corporate governance is the system by which companies are directed and controlled."

2.2 Shareholders and other stakeholders

The “agency” problem, i.e. the divergence of interests between the company management and the capital owners, forms the basis of the corporate governance debate. Another problem, that of interests, i.e. the delimitation between shareholders and other stakeholders such as employees, customers, creditors or the public authorities, is liable to widen the debate. As soon as the corporate governance criteria extend beyond protection of shareholders’ interests, there is a risk of dilution of the performance of companies. Their measurable responsibility to shareholders as the primary entitled group and ultimate decision-making body of the limited company may suffer as a result. As a consequence, the “agency” problem is encountered yet again. Corrective signals by the capital markets are ignored and company resources may be misallocated.

This is not to deny the legitimacy of the interests of other stakeholders. No company can survive in the long-term without highly motivated employees; no company can survive in competition unless it focuses on customer benefit. Corporate governance does not have to place the main emphasis on these aspects as the markets, e.g. labour markets (including collective employment agreement negotiations) and the relevant contractual or public law statutes, are supposed to serve that purpose. Corporate governance falling within the sphere of equity and stock market law can therefore focus on rules for the benefit of capital investors.

In the long-term perspective, the divergence of interests between the different stakeholders of a company looks artificial: after all “shareholders” and other “stakeholders” are sitting in the same boat. The agents of the company therefore endeavour to create the most successful possible relations on every front in the interest of all the stakeholders. This does not preclude the possibility of occasional conflicts, e.g. when jobs have to go in a company which is still profitable. It may well be a matter of judgement whether the company derives long-term advantages or disadvantages from job cuts. In this case it is not a matter of ideological divergences of interest but of factual forecasts. Where the benefits of job cuts predominate for the long-term prosperity of the business, this is not, on closer analysis, a conflict of interest between employees and shareholders but a conflict of interest between those employees who lose their jobs and those who secure their own long-term employment because the competitiveness of the business is strengthened. In a long-term perspective therefore shareholders and employees as a group have the same interests, namely those of strengthening and ensuring the prosperity of the entire company. That is the only way of creating “shareholder value” and of safeguarding existing well-paid and secure jobs and even providing more of them. The company management can therefore to all intents and purposes only have one goal: the long-term safeguarding of the competitiveness of the company, which is equivalent to long-term conservation or enhancement of corporate value. That too is the meaning of “shareholder value”.

2.3 The controlling structures of listed companies

The corporate governance debate, which is heavily coloured by the “agency” problem, applies in the first instance to public companies with a dispersed shareholding structure. That is understandable against the background of the reality in Anglo-Saxon countries, where most listed companies are true public companies. In Switzerland, where more than two-thirds of all listed companies are dominated by large or majority shareholders,[8] corporate governance must also take account of companies of this kind.

Majority shareholders typically exercise direct strategic control and also often operational control over the business dominated by them. This at least erodes the latent conflict of interests between shareholders and company management. Depending on the intensity of shareholder control, this conflict may be almost completely sidelined at the strategic management level. Companies with majority shareholders are therefore closer to the congruence ideal of corporate governance. But their structure brings another problem: that of the relationship between majority and minority shareholders. In principle, the two groups have the same interest, i.e. the long-term conservation or enhancement of corporate value. As the bearers of the main capital risk, majority shareholders can therefore be regarded as optimal company monitors from the standpoint of minority shareholders. This presupposes of course that the majority shareholders in fact respect the legitimate expectations of their minority counterparts.

We must also consider the fact that more and more companies find themselves confronted with major institutional shareholders who are willing, if the need arises, to exercise their voting power critically. This does not alter the fact that “shareholder activism” creates additional costs for institutional investors and the tendency towards passive investment strategies remains strong. The (potential) monitoring function of institutional investors for its part raises corporate governance issues, such as that of internal control of the voting conduct of such shareholders (see Section 9).

8 Cf. Kaufmann/Kunz, Besitzverhältnisse von Schweizer Aktien, Studie der Bank Bär, 1991.

3 The situation of corporate governance in Switzerland today

3.1 Framework for assessment

Various categorisations of corporate governance problems exist.[9] For the purposes of our analytical report, the following distinction has been chosen:

- Shareholders' rights
- Information – disclosure
- Takeover rules
- Board of Directors – Executive Management
- Statutory auditors
- Intermediaries

3.2 Sources

The sources for our inventory of corporate governance in Switzerland are in the first instance the relevant laws and regulations. These include corporate law embodied in the Code of Obligations (Obligationenrecht, "CO"), stock market law (SESTA and pertaining ordinances) and the listing rules (LR) of the Swiss exchange, including the relevant case-law. Attention must also be given to the legal reality in Swiss companies, including the articles of incorporation, the regulations and prevailing usages.

3.3 Presentation

The presentation of the individual chapters in this document is designed to help to structure the corporate governance debate. The following framework has therefore been adopted for discussion of the various topics:

- Legal situation/practice
- Criticism/benchmarks
- Discussion
- Conclusions

9 See e.g. Déminor, corporate governance Rating Service, December 12, 2000 (press release), in which the following subdivision is used:
– Rights and Duties of Shareholders
– Range of Takeover Defences
– Disclosure
– Board Structure and Functioning.

4 Shareholders' rights

4.1 Participative rights – General meeting

4.1.1 Powers of the general meeting

General

Article 698 CO assigns non-transferable powers to the general meeting. These include the right to adopt and amend the articles of incorporation, the appointment of members of the Board of Directors and the statutory auditors, approval of the annual and consolidated accounts and the fixing of a dividend. Swiss law therefore provides better protection for the shareholders' position than do the company laws of the individual US states which allow an amendment of the bylaws or dividend payments to be decided by the Board.[10]

According to the parity principle, Art. 716a CO gives the Board of Directors non-transferable and inalienable powers. These include the strategic management of the company and supervision of the management committee. These rules on powers essentially strengthen the Board of Directors in relation to the management committee. Art. 716a CO gives the Board of Directors also certain inalienable core powers in relation to the general meeting. Corrective measures in favour of shareholders are accorded for instance by the right of the general meeting to dismiss the Board of Directors, liability law and the possibilities of sale and acquisition on the equity markets. With the parity principle, the Swiss legislator determined the division of powers as a binding organisational principle of corporations. The role assigned to the Board of Directors makes the Board a central pillar of corporate governance in Switzerland (see Section 7).

Acquisition of proprietary shares

Legal situation/practice

Under Art. 659 et seg. CO, Swiss law leaves it to the discretion of the Board of Directors to acquire its own shares. However, contrary to EU law, US law does not require the approval of the general meeting in such cases. Unlike US company law and pursuant to EU law there is, however, a limit of in principle 10% of the share capital (including any non-voting share capital).

Criticism/benchmarks

Swiss law has sometimes been criticised for giving the Board of Directors discretion to acquire proprietary shares. EU law requires share buybacks to be approved by the general meeting. That approval can be given for a maximum of 18 months.[11]

The fact that under Swiss law it is theoretically possible for up to 30% of the voting share capital to be bought back without the consent of the general meeting where non-voting shares have been issued in the permitted maximum ratio of 1:2 (Art. 656b para. 1 CO) has also been criticised.

10 Amendments to the articles of incorporation ("charter amendments") require an initial decision by the Board so that e.g. a phased election of the members of the Board of Directors provided in the articles ("staggered board") can be changed only with its consent.

11 See Art. 19, of the 2nd EU directive on company law.

Discussion

The regulation of the buyback of proprietary shares in Swiss law can hardly be described as excessively liberal. The binding statutory limit of 10% prevents the crudest forms of manipulation. The notification obligations under stock exchange law where proprietary shareholding interests reach, exceed or fall short of the limit of 5% or 10% of voting rights ensure transparency at all times in the purchase of equities carrying voting rights. General disclosure obligations also exist in the notes to the annual statement of accounts (Art. 663b Section 10 or Art. 663c CO). These transparency rules, together with the principle of equality of treatment and further legal criteria for handling proprietary shares,[12] including provisions under tax law,[13] greatly restrict the freedom of action of the Board of Directors. This also applies to the theoretical case where, with a capital structure comprising ⅓ voting shares and ⅔ non-voting shares, the Board of Directors wishes to buy back up to 30% of the share capital (i.e. only voting shares and no non-voting shares). The principle of equal treatment will generally rule out this possibility. In addition, the voting rights attached to shares which the company has acquired cannot be exercised (Art. 659a para. 1 CO).

Conclusions

The Swiss system on the acquisition of proprietary shares looks balanced, even if the "checks and balances" are partially different from those provided for under USA or EU laws. At all events, in terms of corporate governance no need for action can be discerned.

Shareholding programmes for staff, management and Board of Directors

Legal situation/practice

Swiss law does not embody any general obligation to submit stock option programmes for staff, management or the Board of Directors to the general meeting ("GM" or "AGM") for its approval or to inform the GM of such programmes. However, the companies regularly keep their shareholders informed through the annual report or the general meeting of the existence of shareholding programmes. Where these programmes are set up by creating conditional capital, the assent of the general meeting is indispensable. (Art. 653 ff. CO).

Criticisms/benchmarks

The listing provisions of the New York Stock Exchange require shareholding programmes for managers and board members to be approved by the general meeting unless they are open simultaneously to a broad circle of staff.[14] This provision must be seen against the background of the fact that the Board of Directors in the USA regularly has approved capital at its disposal and enjoys relatively wide discretion in issuing that capital. The NYSE rule is therefore directed against potential conflicts of interest on the Board.

The UK's Hampel Report declined to make recommendations to companies on the approval of shareholding programmes by the general meeting. That was to remain a matter for the company itself.[15] The "Combined Code" on the other hand stipulates the participation of the general meeting in "long-term incentive plans".[16]

12 E.g. the (restrictive) practice of the Swiss Takeover Board ("UEK") on purchases of proprietary shares via the stock market; see Memorandum No. 1 from the Takeover Commission of September 1, 2000 (Buyback of Shares).

13 See Circular No. 5 from the Federal Tax Administration dated August 19, 1999.

14 See Sec. 312.00 NYSE Listed Company Manual; the most recent proposals of NYSE provide for an unqualified approval requirement.

15 See Hampel Report, 4.21.

16 Combined Code, B.3.4.

Discussion

Shareholding programmes for staff and managers are easy to justify in terms of corporate governance. They can result in an alignment of the interests of shareholders and agents of the company. However, the requirement is that the programmes must be set up with the future in mind, e.g. with blocking periods for the disposal of acquired shares or with deferred option exercise periods.

From the shareholders' angle, stock option programmes may also raise questions, e.g. of their amount or their costs for the business. But this problem applies to all aspects of salaries and forms part of the supervisory obligations of the Board of Directors. Special involvement of the general meeting is not necessary, at least if the costs of the stock option programmes to the company are stated in the annual report. But that is not the case if stock option programmes are fed with newly issued capital. The dilution risk which that causes requires shareholder participation. Swiss law in fact makes binding provision for that participation (Art. 650 ff. CO).

Shareholding programmes for (external) Board members are less common than management stock option programmes. From the corporate governance angle, they do in principle involve the same benefits as management programmes. However, the independence of the members of the Board of Directors may be adversely affected. "Cadbury" and "Hampel" therefore advise against stock option programmes for external Board members.[17] The "Combined Code" does not, however, contain any limitations in this area.

Where the Board of Directors nevertheless takes part in a stock option programme, there is no direct supervisory body; therefore only the general meeting can perform such a role. This needs adequate disclosure to ensure that the general meeting can reach its decision with a full knowledge of the facts, for example in connection with the discharge of the Board members as provided for in Art. 759 CO (see Section 5.1).

Conclusions

Stock option programmes for staff, management and the Board of Directors require further provisions on transparency (see Section 5.1). The creation of special rules on the powers of the general meeting is, however, not imperative in Swiss law.

17 "Cadbury Report", 4.13; "Hampel Report", 4.8.

4.1.2 Convening the general meeting and drawing up the agenda

Period for convening

Legal situation/practice

Art. 700 para. 1 CO stipulates that the period of notice for convening general meetings is at least 20 days. The articles of incorporation may stipulate a longer period than this. No vote may be taken on agenda items which are not stipulated in the invitation, save on a motion to convene an extraordinary general meeting or perform a special audit (Art. 700 para. 3 CO). On the other hand, each shareholder is entitled to table motions on items figuring on the agenda (Art. 700 para. 4 CO).

Circular No. 1/98 of the admission body of the Swiss Exchange states that listed companies must notify the date of their next ordinary GM to the stock market not less than three months in advance.[18]

Criticism/benchmarks

American institutional investors in particular have suggested that the convening period of 20 days is too short, especially as many American investors are registered with Swiss companies solely via "street names" or nominees and an invitation only reaches them by a roundabout route.

The draft EU regulation on a European limited company delegates the definition of the convening period to the corporate law of the Member States.[19] § 123 para. 1 of the German Equity Law stipulates that the general meeting must be convened at least one month before the date on which it is due to be held.

The "Combined Code" recommends that the convening of general meetings and the despatch of the voting material should take place not less than twenty days before the date fixed for the meeting.[20] In this regard it corresponds to current Swiss law.

Under US law, the voting material ("proxy material") is regularly despatched around 60 days before the general meeting. However, substantially shorter periods are stipulated in shareholding law.[21] The relatively early despatch by American corporations is, inter alia, attributable to the fact that US companies are eager to have as many "proxies" as possible. That in turn is explained by the fact that statutory attendance quorums are stipulated in American law for the general meetings of corporations.[22]

Discussion

20 days should in principle be sufficient for appropriate preparation of the general meeting. The fact that notification delays may be experienced by international investors, especially if they are registered solely through nominees, is readily understandable. But these investors are always at liberty to be registered directly as shareholders.[23] It is also a matter of efficient organisation of relations between nominees and beneficial owners for internal opinion forming to be facilitated in good time (within the framework of any applicable rules). In the case of listed companies it is also normal for the invitation to the general meeting to be published in important national and possibly international newspapers.

American investors are subject to different notice periods in their own country. This is because the American GM model places the emphasis of effective opinion and decision shaping on the "proxy" process. This is not the case in Swiss law at present and the introduction of such a concept would necessitate fundamental redesign of the provisions on the annual general meeting. It must be conceded though that in Switzerland too crucial decisions are generally taken before the annual general meeting, as became apparent on the occasion of the disputes between BK Vision/UBS or the hostile takeover bid against Sulzer in 2001. However, it appears that the habitual 20 day notice period applied in Switzerland has not been an obstacle in this regard.

18 Enclosure 1, Sec. 3.01.

19 Draft SE Statute of February 1, 2001, Art. 53.

20 "Combined Code", C.2.4; "Hampel Report", 5.21.

21 § 222 of the Delaware Corporation Law for example prescribes 10 to 60 days.

22 § 216 of Delaware Corporation Law stipulates an attendance quorum of more than 50% ("majority"). This may be reduced by the articles of incorporation/bylaws to one-third of the issued shares but must be approved by the New York Stock Exchange; see Sec. 310.00 NYSE Listed Company Manual.

23 On the other hand, it must be conceded that nominee registrations are the lesser of the two evils by comparison with the unsatisfactory non-registration even from the company's own point of view, see Section 4.1.6.

Companies which would like to make special provision for the wishes of their investors can in any case easily stipulate a statutory advance notice period of a meeting of, say, 30 days.

Conclusions

It would be inherently desirable for the dates of the general meetings of listed companies to be published in advance, e.g. in the stock market information systems. According to stock exchange representatives, this will be the case in the foreseeable future, especially as companies already announce their GM dates at least three months in advance to the stock exchange. This would also enable foreign investors to make early preparations for the next general meeting. For the rest, there seems no reason why companies should not be allowed the discretion to extend the notice periods of general meetings as they think fit.

Agenda

Legal situation/practice

The annual general meeting is in principle convened by the Board of Directors pursuant to Art. 699 para. 1 CO. Under Art. 699 para. 3 CO, the right to convene a meeting is also vested in shareholders who individually or jointly with third parties represent not less than 10% of the share capital. Shareholders who represent shares with a nominal value of at least CHF 1 million (according to the prevailing legal theory, also shareholders with at least 10%) can ask for an item to be placed on the agenda. Shareholders who make use of their right to place an item on the agenda must present their proposals sufficiently far in advance for the Board of Directors to include that subject, accompanied by the motion of the Board of Directors, in the invitation to attend the general meeting. Some companies therefore regularly publish an advertisement in which they invite shareholders who are entitled to place items on the agenda to submit their proposals by a particular date.

Criticism/benchmarks

The 10% threshold for placing items on the agenda is very high for public companies. In the context of the payback of nominal share capital popular of late for tax reasons, the threshold of CHF 1 million of the nominal capital has de facto increased for many companies. The situation in Switzerland contrasts with US law where practically every shareholder is entitled to propose the inclusion of items on the agenda and ask for motions to be put to the vote in the GM.[24] The EU draft for a European limited company[25] on the other hand only stipulates a 10% threshold. However, Member States are entitled to reduce the threshold. German corporate law attaches the right to place items on the agenda to 5% of the share capital or alternatively to a nominal capital of DM 1 million.[26]

Further questions arise in connection with the limitation in time of a right to place items on the agenda. With a view to the optimisation of shareholder rights it would in principle be desirable for the period to expire only after the annual press conference.

24 Looked at in detail, however, the American provisions vary. The share law of the different states for the most part leaves the right to fix the agenda to the companies themselves. For instance Art. 7 of the IBM articles of incorporation stipulates that each shareholder may propose subjects for the next general meeting up to 120 days before the date on which the voting material was sent out in the previous year. This time sequence corresponds to the (binding) provision of capital market law for the inclusion of shareholders' motions in the voting material sent out by the company. SEC Rule 14a-8 additionally stipulates that a shareholder must own at least 1% of the shares in a company or have held shares with a value of at least $2,000 for at least one year. The content of the motions must be confined to matters falling within the competence of the general meeting ("proper subject for action by security holders").

25 Draft SE statute of February 1, 2001, Art. 56.

26 § 122 para. 2 of the corporation law.

Discussion

The right to put items on the agenda stipulated in Swiss law is not comparable with US "proxy" rules because in the USA the formation of shareholder opinion focuses on the "proxy" process. Additional motions or agenda items in the USA may cause the volume of the voting material to grow. The (usually short) general meeting itself is unlikely to be protracted. The (model) structure of the Swiss general meeting on the other hand provides for opinion forming at the general meeting itself, including discussion. The fact that Swiss law sets the hurdle for agenda items higher is therefore understandable and coincides with European benchmarks. Moreover the law only lays down minimum thresholds. The companies are at liberty in their bylaws to reduce the requirements for shareholders to place items on the agenda. That may be recommended, for instance, if the statutory threshold of CHF 1 million has become impossible to reach following repayments of nominal share capital.[27]

When the time limit for motions to place items on the agenda is set, it is legitimate to take account of practical considerations, especially as the timetable from the adoption of the annual or consolidated accounts to the press conference, the invitation to the general meeting and the organisation of the meeting itself is often tight and requires almost military planning precision. Adding further deadlines to this "countdown" for shareholder agenda motions (which are in any case very rare) could result in delays in handling the annual general meeting programme. The Swissair 2001 annual general meeting showed in any case that exceptions could be made if the need arises.

Conclusions

A recommendation might be made to companies to shape the thresholds and time limit provisions to suit their particular circumstances: if there is a sharp reduction in the nominal capital, for example through a corresponding reduction of the CHF 1 million threshold.

27 The same problem also arises in connection with the threshold of CHF 2 million as a prerequisite for the stipulation of a special audit by the courts pursuant to Art. 697b para. 2 CO.

4.1.3 Representation

Legal situation/practical position

Swiss corporate law is based on the model of the physical presence of shareholders at the general meeting (see Art. 689 para. 1 CO). The general meeting therefore does not serve solely (in the typical case) to cast votes but also and particularly to enable opinions to be formed. This contrasts to some extent with US law where the model of the general meeting places the emphasis in opinion forming on the "proxy" process. This explains in good measure why the American "proxy rules" are so very much more detailed and sophisticated in comparison with the Swiss representation provisions. In practice, however, in Switzerland many of the votes at general meetings are also cast by representatives; this not infrequently applies to the overwhelming majority in the case of big public companies. Swiss shareholding law of 1991 therefore made a number of innovations in the area of representation. The present legal situation is as follows:

According to Art. 689 para. 2 CO, each shareholder may himself represent his shares at the general meeting or hand them over to any third party for representational purposes. However, the articles of incorporation may stipulate limitations. Many companies have made use of this possibility and confine representation to other shareholders. In the case of bearer shares, the person who proves possession is able to exercise membership rights (Art. 689a para. 2 CO); to all intents and purposes therefore the possibility of arranging for representation with bearer shares is unlimited.

Art. 689b ff. CO makes a distinction between three categories for the institutional representation of voting rights:

a Representation by an official body of the company (Art. 689c CO): The company is at liberty to propose such representation to the shareholders. The only obligation which the law places in that case is the appointment of an independent proxy holder of voting rights. Swiss law does not embody any further provisions unlike its American counterpart. In particular, there are no specific additional disclosure requirements and no right of the shareholders to include counterproposals and their own suggested agenda items on the voting documents sent to the shareholders.

b Independent proxy holder of voting rights: the law contains no further provisions on the qualifications and tasks of such representatives. However, it is an accepted rule that he cannot have any special relationship of dependence on the company and must respect the instructions of the shareholders (Art. 689b para. 1 CO). The question as to whether the obligation to speak may be imposed remains open. In practice the answer is "no". The manner in which the proxy holder of voting rights may exercise voting rights if he has been given no specific instructions is also contested. The prevailing theory assumes that he must vote in the way which corresponds to the best interests of the shareholders. Companies on the other hand generally take a different (probably permitted) route and stipulate, when the voting material is sent out, that the proxy holder of the voting rights will vote in favour of the Board of Directors' motions unless otherwise instructed.

c Proxy holder for deposited shares: for a long time this approach was a controversial subject in Switzerland. This was because the banks which are closely linked to companies were able to influence many general meetings decisively in favour of the Board of Directors by exercising the votes on shares deposited with them. Art. 689d para. 3 CO defines proxy holder for deposited shares as institutions which are governed by the banking law and professional asset managers. Their obligation is to obtain instructions for the shares deposited with them before each general meeting.[28] Otherwise they may not exercise the relevant voting rights despite having a power of attorney. Where instructions cannot be obtained from the depositor in good time, the proxy holder for deposited shares must comply with any general

28 However, companies with registered shares will regularly write directly to the registered shareholders (in compliance with their articles of incorporation).

instructions which have been given. If there are no general instructions, he must cast the deposit votes in favour of the motions of the Board of Directors (Art. 689d para. 2 CO).[29]

In practice, the provisions of the corporation law of 1991 have created a situation in which the banks often do not even exercise their deposit votes for cost reasons. At controversial general meetings (see UBS general meeting concerning BK Vision, Swissair AGM 2001, Sulzer AGM 2001 etc.), deposit votes can still play an important role.[30]

Criticisms/benchmarks

The criticism that representation at general meetings in Switzerland by non-shareholders is not allowed is a misunderstanding of the situation. The law allows this but exclusion may be set out in the articles of incorporation. Proxy holders for deposited shares and independent proxy holders of voting rights need not themselves be shareholders either. The same provision applies to the representatives of legal entities, who must simply prove their identity as an official body or authorized representative of the shareholder concerned.

Section 7 of the draft by the Swiss Pension Fund Association on the issuance of corporate governance recommendations expressly stipulates that shareholders should have the possibility of arranging to be represented at the general meeting by another independent shareholder.

One special problem of Swiss companies resides in the large number of shares which have not been registered at all by their owners and for which voting rights therefore cannot be exercised; this may amount to 20 or even 50% or more in the case of some companies. The transfer of the trade in Swiss “blue chips” to the European “virt-x” exchange platform is likely to cause the number to increase further because a growing number of foreign brokers will be trading in Swiss shares without understanding Swiss requirements and without cooperating with Swiss banks. Allowing of nominee registrations might alleviate the problem (see Section 4.1.6).

Discussion

The opening of the general meeting to non-shareholders as representatives of shareholders is quite rightly a matter for the company. Non-admission may make sense for smaller companies when the need is to keep unknown representatives of competitors away from the general meeting. However, such hurdles can easily be circumvented. On the other hand, the importance of the general meeting has declined to such an extent that information which is relevant to the share price is a matter of ad hoc publicity and is therefore no longer reserved for AGM participants. Moreover, it is perfectly reasonable to suppose that institutional investors and analysts will gain access to the general meeting simply by buying a single share. Various companies in any case allow guests to take part. From the point of view of the shareholders who arrange to be represented and do not wish to entrust the representation to other shareholders or other bodies, the independent proxy holder of voting rights can be used. Legal entities may in any case arrange to be represented by anybody. Limitations in the bylaws (e.g. mandatory representation by official bodies) are not habitual and would present a problem from the legal angle. As a result, in principle nominee companies are also able to issue powers of attorney to beneficial owners if the latter, by way of exception, whished to represent their shares themselves.

29 This is a difference from the German provisions under which the vote is exercised according to the proposals of the custodian bank in the absence of other instructions; § 128 para. 2 Shareholding law.

30 The relative importance of deposit votes is probably greater for bearer shares than for registered shares because of the absence of any direct contact between the company and its shareholders.

US style "proxy" rules are not required in Swiss law, at least until the model of physical attendance at the general meeting is abandoned. The Swiss immediacy model requires opportunities for discussion and opinion forming at the general meeting itself. This is yet another reason to limit representation at the AGM by non-shareholders. It is quite another question whether this model will still be relevant in the future. Globalisation, falling attendance rates at general meetings, the growing number of unregistered shares for which voting rights cannot be exercised and the widespread rational apathy of shareholders might eventually lead to a change of paradigm. But this would of course be a matter for the legislator.

Conclusions

The recommendation might be made to companies not to limit representation by non-shareholders through their articles of incorporation in so far as there are no special reasons for doing so and no possibility of at least passive attendance at the general meeting exists for non-shareholders (e.g. via the Internet or admission of guests).

At the legislative level, an examination may be made as to whether the Swiss AGM model ought not to be reformed to create a "proxy" model in which the emphasis in opinion forming would typically be ahead of the AGM as such.

4.1.4 Holding the general meeting

Legal situation

Preparation and implementation of the AGM are a matter for the Board of Directors (Art. 702 CO). The articles of incorporation or standard practice in principle leave the Chairman of the Board of Directors to take the chair. His powers are not defined by law but, according to prevailing theory and practice, comprise the formal conduct of the general meeting, including the limitation of speaking time, appointment of the tellers, the voting procedure and policing of the meeting. Votes may be taken in public (by show of hands), in writing or electronically within the framework of the provisions made in the articles. Agenda items will in principle be stated in the invitation. Where the agenda refers to the reelection of several Board members, a single block vote may be taken unless other motions are tabled.

According to Art. 689e CO, details of proxy representation must be determined by the time of the general meeting and made known if a shareholder so requests. In practice the announcement is regularly made without any particular motion to that effect.

Criticism/benchmarks

Section 7 of the draft of the Swiss Pension Fund Association recommends an appropriate organisation of the general meeting including the time, place and available resources (loudspeaker system, translation). Emphasis is also placed on the need for independence of the tellers (Section 8). The practice of taking votes to the Board en bloc is sometimes criticised.

Corporate governance questions of a special nature arise in connection with the new media, especially the Internet. The relevant possibilities are already being used in the USA and to some extent also in Germany (e.g. Daimler Chrysler). In Switzerland in 2001, for example, Zurich Financial Services held its GM simultaneously in Zurich and London with intercommunicating video and sound equipment. This permitted live contact at any time. ABB used to make similar arrangements between Zurich and Stockholm. Other companies, e.g. Swiss Re, make their invitation and voting material available via the Internet and also enable authority to be given (to the official bodies) via the Internet.

Discussion

General: The Swiss Code of Obligations (CO) says little about the conduct of general meetings. The freedom of interpretation and judgement allowed by the Code is partly made good by theory and practice and partly also by provisions included in the companies' own articles of incorporation. There are also best practices, e.g. the possibility for shareholders to put forward their questions and motions in advance of the AGM in writing and without the need – unlike US practice – to attend the AGM in person. Another best practice rule states that existing motions by shareholders must be announced when an agenda item is taken up. However, there can be no question of a manifest need for rules or recommendations.

New media – Internet: The transmission of GM proceedings by Internet is permissible. It might even be conceivable for Internet users with appropriate identification to be able to put questions to the Board of Directors. On the other hand, voting via the Internet would conflict with the "immediacy principle" of the Swiss AGM. A special legal basis would therefore have to be set up for Internet general meetings as such. Also regulations on the valid casting of votes would have to be enacted, possibly along the lines of rules about electronic signatures. Internet AGMs would require a transition to the American "proxy" model and might therefore also involve additional regulation of information for shareholders prior to the AGM. On the other hand, TV transmissions between two places are already permitted under existing law.

Block election of Board Members: As regards the block elections of Board Members, attention must be called to the efficiency of this procedure and the possibility of motions being submitted to request individual elections. However, such motions require a majority vote at the AGM unless the articles of incorporation provide for lower quorums. In the event of opposition to some of the proposed Board appointments, the Board itself may also divide the voting procedure into, say, two blocks. Block votes may be used not just for Board elections but also for other subjects, especially if a series of votes refer to the same subject.

Tellers: The independence of the tellers is essential. A detailed definition of the meaning of independence is hardly necessary because this practice creates no difficulties at Swiss general meetings.

Voting procedure: Questions also arise in connection with the voting methods at the general meeting. Public votes are both efficient and practical but may lead to difficulties in determining the result of a vote. Written votes are long-winded and complex so that they are certainly not suitable as a standard method. Electronic voting techniques, e.g. "televoting", are expensive and complicated and therefore only useful for very large general meetings. In principle here too the immediacy model of the Swiss general meeting encounters practical limits which would have to be reviewed when the law is reconsidered. "Proxy voting" or voting by correspondence would be alternatives.

Quite apart from the actual voting procedure, for reasons of transparency it is mandatory for the outcomes of votes to be announced at the general meeting and recorded.

Conclusions

A Code of Best Practice could in principle contain rules for the conduct of general meetings and a definition of the terms of reference of the Chairman. To the extent that these matters are obvious this would not be advisable. Difficult practical situations can in any case be brought under control by methods other than Best Practice Rules. A cool head and a sensitive touch are at least as important.

The redesign of the general meeting to introduce the "proxy" model (at least as an option for companies) would enable matters relating to conduct of the meeting to be regulated in a new and useful manner.

4.1.5 Entitlement to vote

Reference date of registered shares

Legal situation/practice

In the case of registered shares, the date of entry in the share register determines the voting entitlement (Art. 689a para. 1 CO). Where purchases and sales are made in the period immediately before the AGM, the prevailing theory and practice allow a key date to be fixed. This must be as close as possible to the date of the AGM.[31] However, allowance must also be made for practical considerations. A period of 5 to 10 days before the general meeting should be permissible. The fixing of a "real" key date logically means that a sale after that date will have no influence on the right of the seller to vote in the relevant AGM . In practice, however, a "differentiated" key date concept is frequently used in which a sale after the key date leads to the seller's immediate loss of entitlement to vote. Since the buyer's name does not yet appear in the share register he too is not entitled to take part in the AGM. That is permissible if the key date is less than 20 days before the general meeting (Art. 685g CO).

Criticism/benchmarks

A comparison with US law shows that the latter works with "record dates" to determine the voting entitlement of registered shareholders. This can be set in most states at between 10 and 60 days before the general meeting.

Discussion

From the corporate governance perspective the ideal solution would in principle be for the key date to coincide with the AGM day because that would ensure the simultaneity of the interests of shareholding ownership and voting entitlements. If practical considerations require the key date to be advanced, the difference should be as short as possible. In the case of big public companies in particular the use of modern technology should enable the key date to be just one day before the GM. In that case the matter ceases to be a real problem.

The fact that the US rules are more generous does not make them necessarily better from the corporate governance angle. However, US circumstances are not comparable with those prevailing in Switzerland, in part because the share register must be open to shareholders in the USA when an AGM is about to be held and the US "proxy" process is much more complex and requires greater preparation.

31 The fixing of a "real" key date in the sense of a "record date" is recommended by P. Böckli, Schweizerisches Aktienrecht, 2nd edition, Zurich 1996.

The American “proxy” process is rendered still more complex by the fact that most shareholders arrange to be entered in the share register through nominees and this too is regularly done only indirectly (i.e. through further intermediaries). This may delay the process of mailing and communication between the company and the beneficial owners. The fact that nominee solutions have also gained acceptance in Switzerland and may be further extended (see 4.1.6) could lead to the abandonment of the “ideal simultaneity” of the key date and AGM in Switzerland too. The entry of new shareholders via nominees until shortly before the general meeting would raise serious doubts as to whether under those circumstances adequate communication with the beneficial owners would still be feasible before the AGM. In so far as companies already operate with nominee quotas, from the corporate governance angle this should be taken into account when setting and assessing key dates even under existing law. In principle, we see once again that the current Swiss AGM model is not entirely suitable for modern requirements and should be fundamentally reviewed.

Conclusions

A Code of Best Practice might recommend setting the key date, which may in principle be both “real” or “differentiated”, no more than a few days before the general meeting. However, with the introduction of nominee solutions some flexibility would be needed in this regard. If the AGM concept is reconsidered by the legislator, the key date problem would have to be reviewed.

Bearer shares

Legal situation/practice

With bearer shares possession determines the voting rights unless the Board of Directors makes different arrangements (Art. 689a para. 2 CO). In practice the shares must generally be deposited with a financial institution and this too must be done by a key date. The depositor then receives his admission card (in a personal capacity) after depositing his shares.

Criticism/benchmarks

Foreign institution investors sometimes criticize the deposit requirements for bearer shares. They suggest that it restricts the possibility of disposing of those shares.

Discussion

The depositing requirement for bearer shares may be regarded as essentially sound from the point of view of an efficient verification of legitimacy. For corporate governance purposes, the effort to be made by the shareholders should be minimized as far as possible and the disposability of the shares not restricted. Provision to that effect would be unnecessary if organisational measures could be taken to prevent the issue of two admission cards for the same bearer share. On the other hand, at least if the blocking periods are short and the shareholders concerned have long-term commitments, the restriction of the freedom to dispose of the shares would remain negligible. Shareholders who are “on the way out” may in any case decide whether the possibility of “voting with their feet” is preferable to voting at the AGM. Moreover, a deposit requirement cannot prevent the transfer of ownership, as under Art. 924 CC the notification of ownership remains possible (i.e. change of ownership by notification to the depositor). In practice it must be remembered that bearer shares are a less important factor on the present Swiss stock market scene than they were a few years ago as registered shares have generally been created because of the market trend towards “one share, one vote”.

Conclusions
The deposit practice applicable to bearer shares is not a particularly grave issue and there is no need for special recommendations.

4.1.6 Unregistered shares – Nominees

Legal situation
One special feature of Swiss provisions limiting the transferability of shares in listed companies is that shareholders who sell their shares on the stock market immediately lose all rights and are deleted from the share register following notification by the vendor bank (Art. 685e CO). On the other hand, the buyer is only entered in the register if he makes an application for such entry. Investors whose interest in exercising voting rights is minor have little incentive to make an application for registration because according to the practice of the banks and companies they receive their dividends even without such registration. The number of unregistered shares in Swiss companies has therefore reached as much as 50% or more in some cases.

Criticisms/benchmarks
Unregistered shares amounting to 20–50 % or more is not desirable from the corporate governance angle. The situation is comparable with abstention from voting in political elections and may even be more problematic. Unlike political voters, who always have access to the relevant voting material, the unregistered shareholder does not receive any AGM invitations and is therefore in principle not aware of pending matters affecting the company. Nor can it be claimed that the unregistered shareholder in effect takes an informed decision to delegate his rights to the other shareholders.

As a corrective measure to solve the problem of unregistered shares, active participation by the intermediaries (e.g. the buyer banks) to register their customers is desirable. Nominee solutions as is standard practice in the USA could also alleviate the problem. Some Swiss companies allow nominee quotas.[32]

Discussion
Where registered shares are transferred on the stock market, the rights pass to the purchaser on transfer (Art. 685f para. 1 CO). The vendor bank must notify the sale immediately to the company pursuant to Art. 685e CO and the previous shareholder is then deleted from the share register. On the other hand, the new shareholder has no need to register and the buyer banks have no statutory obligations in this regard either. For data protection reasons, an obligation to notify to the company could not be justified. On the other hand, it might be conceivable to call upon the purchaser banks to make active efforts to enter buyers in the share register. In the first instance information would be provided with the forwarding of company-specific registration forms or an effort to persuade shareholders to sign registration forms applicable to Swiss companies in general. That request would of course not be directed only at the Swiss banks but at all custodian banks which manage portfolios of Swiss equities. But it must be acknowledged that a stronger commitment on the part of purchaser banks could not eliminate the basic problem of the "rational apathy" of shareholders in respect of voting rights.

32 A radical solution to the problem of unregistered shares might be to cease paying dividends to unregistered shareholders. But this is generally regarded as impossible to implement for capital market policy reasons.

Nominee solutions might be another means of ending the notorious problem of unregistered shares in Swiss public limited companies. A working group SIS SegaInter-Settle made up of banks and representatives of the public companies is currently looking into this matter. A disadvantage of nominee quotas is seen to reside in the anonymous nature of the circle of shareholders. This may lead to the loss of control over compliance with restricted transfer percentage limits. Some companies therefore only permit the registration of nominees up to a given percentage (which may correspond to the restricted transfer percentage clause) and also stipulate that within this quota a single beneficial owner must not exceed a certain limit anonymously.

The cautious practice of the Swiss companies in connection with nominee quotas is partly related to the doubts over the enforceability of statutory notification obligations in relation to foreign shareholders and intermediaries. However the statutory provisions are clear: according to Art. 20 SESTA, in conjunction with Art. 9 para. 1 SESTO-SBC, economic beneficiaries must report their holdings as soon as they reach, exceed or fall short of the threshold of 5% of the voting rights in a particular company. It is immaterial here whether the voting rights can be exercised or are not even registered. The disclosure office of the Swiss Exchange has also made clear in a notice of February 26, 1999, the (additional) requirement for the disclosure of shares held by nominees. A nominee must disclose his shareholdings on reaching or passing legal thresholds to the extent he is authorized to exercise voting rights autonomously.

In the event of an extension of the nominee system, the question as to how the nominees exercise their voting rights would also have to be resolved. In US law, clear prescriptions on the need to obtain instructions from the beneficial owners exist. In Switzerland such standards do not exist, unless Art. 689d CO on proxy holding of deposited shares were to be applied in an analogous manner. However, that would be hard to justify from the legal angle because Art. 689d CO starts out from the assumption that the depositor remains the formal shareholder. A different solution might apply at best if the custodian bank and the nominee company were to be closely linked in legal terms or at least economically. Contractual solutions for businesses with nominee companies are conceivable but will encounter difficulties at least if further intermediaries are involved behind the nominee companies.[33]

Nominee quotas associated with a corresponding assurance of communication with the beneficial owners are therefore a plausible approach to a solution of the problem of unregistered shares from the corporate governance angle. This could ensure that the beneficial owners receive the necessary voting and information material for every annual general meeting. But the real "litmus test" resides in practical experience. To be sure, the experience of Swiss companies in this regard has not been particularly encouraging up to now. Doubts are voiced as to whether nominee solutions would in fact result in a more active exercise of voting rights. Sophisticated nominee solutions in the US style also generate substantial administrative costs.

Conclusions

The problem of unregistered shares might be solved in at least two ways: through a greater commitment of the purchaser banks to shareholder registration and by the promotion of nominee solutions. A Code of Best Practice might, for example, contain a requirement for the purchaser banks to make active efforts to enter their deposit customers in the share register. If the nominee system is extended the question of the exercise of voting rights by the nominee companies will also have to be resolved. To the extent that this cannot be brought about through contractual arrangements of the companies the legislator would have to consider the matter (see Section 9).

33 This is, for example, regularly the case in the USA where 80–90 % of the registrations are often made by nominees. Big nominee companies act for this purpose. Brokers and possibly other intermediaries are involved behind them.

4.1.7 Relationship between voting rights and capital shareholdings

Legal situation

The organisational autonomy of corporations in Swiss law is substantial in respect of the relationship between voting rights and capital shareholdings but is certainly not unlimited. The opening of a gulf between the capital shareholding and voting rights is made possible by the following provisions:

— limitation of the transferability of registered shares (Art. 685d ff. CO)
— voting cap clauses (Art. 692 para. 2 CO)
— non-voting shares (Art. 656a ff. CO)
— (multiple) voting right shares (Art. 693 CO)

On the other hand preferential shares do not lead to discrimination with regard to voting rights as they do not grant preferred voting rights but merely special financial rights. Profit participation certificates by definition are issued without a capital investment. In the case of these papers too there is therefore no disparity between the capital interest and voting rights, at least in formal terms.

Non-voting shares and (multiple) voting right shares cannot be created without limitation. The non-voting share capital must not exceed twice the voting share capital (Art. 656b para. 1 CO). (Multiple) voting right shares may not amount to more than one-tenth of the other equity capital (or one-eleventh of the total equity capital) (Art. 693 para. 2 CO). Art. 693 para. 3 CO also provides exceptions to the voting rights privilege for certain decisions of the annual general meeting. Art. 709 CO protects the non-privileged shareholders through the right to take a seat on the Board of Directors. The position of the non-voting shareholders is protected in various ways against opportunistic action by voting shareholders (e.g. Art. 656 ff. CO).

Criticism/benchmarks

The "one share, one vote" principle is repeatedly referred to by financial journalists, financial analysts and institutional investors. The Swiss Association of Pension Funds also recommended the principle of "one share, one vote" in its draft corporate governance recommendations without giving reasons and guidelines for exceptions. In the USA on the other hand the "one share, one vote" principle was made more flexible many years ago. In the 1920s the New York Stock Exchange introduced a rule of this kind but already allowed exceptions (e.g. for Ford). The rule has been eased since the 1950s. Today it exists only in the form of a "disenfranchisement rule".[34] When a stock market listing is arranged, this permits in principle the adoption of any desired structure. However, after the stock market listing structural changes may be made only if they do not discriminate against the voting rights of existing shareholders. The disappearance of a "one share, one vote" dogma in the USA has also been apparent recently, for example on the occasion of the acquisition of CBS by Viacom, in which no opposition was voiced against the fact that CBS shareholders were only offered non-voting stock of Viacom. That enabled Sumner Redstone to retain his voting majority of around 70% in Viacom despite the takeover. New types of shares (e.g. "tracking stock") also dilute the classical congruence of capital interest and voting rights.

34 See NYSE Listed Company Manual, Sec. 313.00.

In Europe on the other hand the development seems to be taking place with a "time lag". Mention might be made of the (now obsolete) 5th EU company law directive which sought to embody the "one share, one vote" principle. The draft European company statute (SE) of 1991 proposed permitting shares without voting rights only in cases where they were accompanied by special advantages. However, the latest draft of February 1, 2001, dropped this principle completely.[35] In Switzerland the market trend towards a unitary share has been evident in recent years, especially for companies with a broad shareholding structure.

In Germany, KontraG now prohibits maximum voting clauses[36] while in the USA they are permissible under the rules of the New York Stock Exchange: "capped votes" are regarded as straightforward if they already existed when the company was first listed.

Discussion

The following distinctions should be made when considering the demand for "one share, one vote" from the angle of corporate governance:

1. At the incorporation stage or at the stage of "going public" shareholders' rights must be designed in such a way that investors are willing to expose their capital to the entrepreneurial risk under the prevailing statutory conditions and those of the articles of incorporation. However, this is a task which the capital market can perform in an economically efficient manner. Transparency is the sole prerequisite. To the extent that investors accept non-voting shares, transfer limitation provisions, voting cap clauses or shares with diminished voting rights when the "going public" is arranged there can be no objection from the corporate governance perspective. On the other hand, it is reasonable to suppose that added value is created by this flexibility which would otherwise be lost because entrepreneurs would not be willing to implement a "going public" at all under different background conditions.
2. If on the other hand transfer limitation provisions, voting cap clauses or (multiple) voting right shares are created at a later stage, these can interfere with the legitimate expectations of shareholders. The problem of the protection of expectations therefore arises. This is a legal issue as it cannot be solved effectively by the market (problems of opportunism, "collective choice"). Because shareholders who are prejudiced in voting right terms have already invested their capital and cannot simply realize the value of their shares, the latitude of the general meeting must be reasonably limited ("protection of minorities"). Allowance must be made for the fact that it is not in the interest of the company and therefore not in the interest of shareholders either to deprive the general meeting of the possibility of changing structures and requiring unanimity for all such decisions. Hence, the aim must be to find a reasonable balance between the expectations of the shareholders concerned and the interests of the company and the majority of the shareholders in order to retain flexibility.

35 An expert report commissioned by the EU now suggests in connection with the new version of an EU takeover directive that multiple voting rights and voting right limitations should be ruled out when votes are taken on the introduction of defensive measures. In addition, a shareholder should be able to exercise his limited voting rights in full once he possesses at least 75% of the equity capital. The Member States are expected to be able to reduce this threshold, but not to increase it; Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids, Brussels, January 10, 2002, see NZZ of January 11, 2002, p. 17.

36 Art. 1.2 of the German corporate governance Code contains the following more far-reaching recommendations: "Each share in principle gives the entitlement to one vote. Shares with (multiple) voting rights or preferential voting rights ('golden shares') and capped voting rights do not exist."

When assessing the principle of "one share, one vote", a distinction must therefore be made in the first instance between the pre-existing situation at the time of "going public" or the issue of stock with voting right disadvantages and the subsequent structural changes made to the detriment of the voting rights of existing shareholder groups. This corresponds to the concept underlying the rules of the New York Stock Exchange.

Anyone who purchases non-voting shares, shares with disadvantaged voting rights, shares with limited transferability or shares at a time when the articles already contain a voting cap clause, is in effect seeking an (economically inefficient) "windfall profit" if he subsequently uses the help of the legislator or other regulatory authorities to gain acceptance for the principle of "one share, one vote".

The situation is different in the case of shareholders to whose detriment structural changes affecting voting rights are subsequently made. In their case Swiss corporation law provides a great many safeguards. These include in particular:

— The opportunity to contest decisions of the general meeting which breach the requirement of "reasonableness" or the principle of equal treatment (Art. 706 CO);
— The prohibition on deleting the names of registered shareholders from the share register when a transfer limitation clause is introduced;
— Qualified quorums for the introduction of shares with (multiple) voting rights and share transfer restrictions (Art. 704 CO).

The interests weighed up by the legislator in this connection appear to be appropriate.

However, three further arguments might be invoked in favour of the "one share, one vote" principle:

— The argument of market efficiency based on uniformly harmonised share structures;
— The argument of increased market liquidity;
— The undesirable use of voting right limitations to protect against takeovers.

The first argument is telling to the extent that uniformity reduces transaction costs on the capital or equity markets. But these efficiency benefits are apparently neglectable in comparison with the efficiency benefits of variety and flexibility specific to the enterprise from the corporate finance angle. Otherwise the market would already have implemented these provisions to a greater extent than is the case. There are no plausible reasons for market inefficiences in this area, especially as e.g. the transition of various companies to the unitary share has shown that unitary structures take effect in cases where companies expect them to bring benefits. In addition the diversity of types allowed under Swiss corporation law is not unlimited. The transfer limitation regime in principle only allows for percentage clauses (Art. 685d para. 1 CO). Art. 4 of the transitional provisions on the 1991 corporation law enables purchasers to be declined voting rights "to the extent that and as long as their recognition might prevent the company from producing the proof required by the federal laws of the composition of the circle of shareholders." But this "foreigners" clause has no practical importance. Art. 19 of the listing regulation contains a further safeguard for the market-efficient tradability of listed registered shares and allows the Swiss Exchange to "unify the registration procedure for registered shares" (para. 4).

The second argument is a telling one to the extent that for example unitary shares might in fact contribute to improved liquidity of the shares market. But improved liquidity is in principle in everyone's interest and it may therefore be assumed that the market would generate such liquidity in so far as the interest in the diversity of corporate financing is not assumed to be greater. A further consideration is that limited share liquidity already exists when dual class shares are issued and is therefore accepted willingly by investors.

The third argument that transfer limitation clauses, voting cap clauses, non-voting shares and (multiple) voting right shares can be used for takeover protection purposes may be valid to some extent, for public companies with a dispersed shareholder structure, because every takeover hurdle ultimately makes the "agency" problem more acute. The simultaneity of capital participations and voting rights in these companies is therefore conducive to optimum control of corporate decision makers by the capital market. The "one share, one vote" problem is then reduced to the question of the admissibility of defensive measures. Here too, however, it is all a matter of reasonable "checks and balances" (see Section 6, including 6.3.) .

Conclusions

The discussion of the equivalence between capital shareholdings and voting rights must not, in the interest of efficient corporate structures, lead to a situation in which structural differences which develop and gain acceptance on the market would be destroyed by state regulations on the "one share, one vote" principle. The market success of heterogeneous capital structures gives strong reason to suspect that the different voting rights for capital investors may be an efficient solution. It is for the market, and not the legislator or other regulatory bodies, to decide in the first instance when structures are suboptimal in a particular case.

But legislation and market regulation have legitimate functions if action prejudicial to the assured legal positions of shareholders is taken. For such "ex post" interference the substantive instruments of Swiss corporation law seem to offer sufficient protection.

4.2 Controlling rights and entitlement to file legal actions

The "checks and balances" embodied in corporate law are based on a division of powers between shareholders, the Board of Directors, the management committee and the statutory auditors. This division must not deflect our attention from the fact that all the structures of the corporation ultimately have to serve the interests of the shareholders ("shareholder value"). Considerations of transaction costs, including "collective action" and "lock in" problems, require shareholders' rights to be properly channelled. This results in an optimisation problem, which the 1991 corporation law solved by extending shareholders' rights. These include not only participation rights but in particular the controlling rights of shareholders and their entitlement to file legal actions. In this connection, information rights play a central role (see Section 5). The special audit provision is new and undergoing the "Swissair Test" (Art. 697a ff. CO). This enables the general meeting to appoint a special auditor under the control of the judge. The purpose of the special audit is in particular to obtain information on responsibility and the possibility of taking legal action to contest decisions. Even in the event of rejection by the AGM a special audit may be requested by shareholders who alone or jointly with others represent 10% or CHF 2 million of the share capital (Art. 697b para. 1 CO). In this case it is necessary to give credible proof of damage to the company by actions taken by their official bodies which are incompatible with the law or articles of incorporation (Art. 697b para. 2 CO). The special audit to some extent replaces the "discovery" principle which plays a central role in the USA.

In respect of legal actions seeking to define the responsibility of the Board and contest shareholders' resolutions, the Swiss provisions (contrary to the German law on responsibility) give every shareholder the right to take action without any percentage hurdle. The law of responsibility is quite severe by European standards (e.g. liability for minor negligence, admission of natural suspicions in support of accusation proof etc.). The question of costs is still probably a deterrent but the judge is at liberty to apportion the costs between the company and the plaintiff if the legal action is rejected (Art. 706 para. 3, 756 para. 2 CO). However, the economic incentive to file an action remains small and contrasts with the US law, which is extremely friendly to the plaintiffs (success fees, class actions, "discovery", low court costs, no party cost compensation, etc.).

5 Information – Disclosure

5.1 Accounting rules including disclosure of management and Board of Directors' remuneration

Legal situation/practice

For companies listed on the Swiss Exchange, Art. 64 of the Listing Rules ('LR') requires a "true and fair" annual report according to ARR or a recognized international accounting standard. These include in particular IAS and US-GAAP (Art. 70 LR; see notification from the Swiss Exchange No. 20/2000 of 18 December 2000). Of the over 400 listed companies in Switzerland more than one-quarter now present their consolidated accounts according to IAS or US-GAAP standards. For the individual account statements of the issuers, CO rules are frequently still used.

Art. 65 LR governs interim account statements. It stipulates that an (unaudited) half-yearly report must be published in consolidated form.

Art. 72 LR further requires the issuer to publish facts relevant to price as soon as he is informed of them. Deferral is only permitted if it is attributable to a plan or decision of the issuer and would affect the justified interests of the issuer. The breach of Art. 72 LR may lead to administrative sanctions by the stock exchange and possibly also to claims for compensation in civil law under 41 et seq. CO. An open theoretical question is therefore whether the breach of Art. 72 LR can be regarded as unlawful because the listing rules do not constitute a law in the true sense of the term. The fact that the listing regulation is based on Art. 8 of the Stock Exchange Law ('SESTA') suggests this to be the case. Breach of Art. 72 LR may possibly also result in criminal law penalties according to Art. 152 StGB. Art. 152 StGB makes "untrue or incomplete information" in "public announcements by commercial businesses" a punishable offence.

With respect to the disclosure of accounts under the LR, Art. 697h CO which requires the disclosure of the annual and consolidated accounts of listed companies has no practical significance.

By international standards, the LR is restrictive in respect of the disclosure of Board and management remuneration. Sec. 1.2 of Schedule A in the annex to the LR does require a range of information about the official bodies to be disclosed in listing brochures but also the overall number of shareholding rights which the members of the Management and Supervisory Bodies hold in the issuer (sec. 1.2.2). On the other hand, when the LR was adopted the authors deliberately refrained from including an obligation of regular disclosure of the remuneration of Board members and management.

Criticism/benchmarks

The corporate governance recommendations of the Swiss Pension Fund Association on the information of shareholders repeat postulates which are already assured by the LR. The requirement for the creation of a contact agency for investors or for the press (investor relations, PR) is also in all probability adequately satisfied by most companies.

Swiss listed company law does not contain an obligation to submit quarterly reports as is the case in the USA.

By comparison with US law, Swiss law is less friendly to legal actions by investors. Quite apart from the known procedural differences, there are also differences in substantive law. The "fraud on the market" theory in US law enables claims for compensation to be already made if it can be shown that incomplete or incorrect information was given to the market without any proof of the specific cause and effect relationship between the wrong information and the loss suffered by the plaintiff. On the other hand, under Swiss law, all the requirements stipulated in Article 41 et seq. CO must be demonstrated. We have already called attention to the particular difficulties in the event of breach of Art. 72 LR.

Criticism of the Swiss disclosure rules is confined almost exclusively for the time being to a requirement of disclosure of compensation for Board members and management. This criticism has been further nourished by recent events. The Swiss Banking Commission also warned, in connection with its approval of the general review of the LR in 2000, that a disclosure obligation would be introduced when a forthcoming revision takes place. Section 15 of the corporate governance draft of the Swiss Pension Fund Association recommends disclosure of the remuneration of the Board of Directors in a general form.

Discussion

The massive improvement in the transparency of Swiss companies in recent years is essentially attributable to two factors: more stringent accountancy rules and the pressure of the capital markets. The latter has induced a large number of Swiss companies to choose more stringent international transparency standards, especially International Accounting Standards (IAS). To the extent that listing has taken place in the USA, the companies are required to produce US-GAAP Reporting (or at the very least US-GAAP "reconciliation" at year end). On the other hand, the expenditure incurred by companies to comply with international publicity requirements is significant. Moreover, more information is not necessarily synonymous with better information. The principle "less is more" may also be valid in this instance. Attention may be drawn for example to the constantly discussed risk that an obligation to publish quarterly reports may encourage shortsighted management thinking.

The focus of the present discussion of the subject of disclosure in Switzerland is the remuneration of Board members and management.[37] With reference to management remuneration, the Board of Directors must perform a clear supervisory role. "Checks and balances" should in principle exist here. Nevertheless from the corporate governance perspective, disclosure of the overall management remuneration does appear justified. There are at least two reasons for this:

1. Management remuneration is a central incentive mechanism to tie in agents of the company with the interests of shareholders. This suggests the need to disclose the corresponding numbers to the shareholders and to explain their structure. In addition a distinction must be made between fixed salaries and bonuses on the one hand and stock option plans on the other.
2. The market demand for international managers has caused the remuneration of top managers to increase to such an extent that there is a risk of overpayment. A disclosure of the total remuneration of the management may therefore do much to enhance confidence.

Disclosure of the overall remuneration of the Board of Directors is already justified by the fact that the Board must of necessity fix its own remuneration. However, an overwhelming majority of Swiss companies already publish these numbers today.

37 A number of parliamentary initiatives have been tabled on this matter such as the Leutenegger Motion of March 22, 2001 (National Council) or the Walker Motion of June 20, 2001 (National Council).

Severance payments to outgoing managers and possibly Board members raise special questions. This matter has become topical in the light of recent occurrences in Switzerland. Here too transparency seems to be a valid means of preventing abuse. On the other hand, there are legitimate data protection interests of the persons concerned. It therefore seems worthwhile permitting severance grants to be pooled with the other management remuneration while disclosing the relationship between the severance grant and the previous annual salary of the person concerned in the case of individual departures.

Not to be confused with the (ex post) disclosure of severance grants paid is the question, which is relevant in the context of takeover problems, of the (ex ante) agreement on "golden parachutes" (see Section 6.1.).

Conclusions

Disclosure of management and Board remuneration will be part of the transparency directive of the Swiss Exchange. This appears to be appropriate. From the corporate governance standpoint separate disclosure of overall remuneration of the management and Board will suffice. Subdivisions according to fixed salaries and bonuses on the one hand and stock option plans on the other make good sense. In addition, companies should be offered some flexibility with regard to the form in which severance arrangements for members of the management or Board of Directors are presented.

5.2 Disclosure of shareholder and corporate governance structures

Legal situation/practice

Art. 20 of the Stock Exchange Law requires shareholders who either directly, indirectly or in agreement with third parties attain, exceed or fall short of the limit of 5, 10, 20, 33 ⅓, 50 or 66 ⅔% of the voting rights in a listed company to serve notification within four days to the company and the Stock Exchange. The company must publish the information notified to it within two further days (Art. 18 SESTO-TB). Art. 663c CO also requires companies to name major shareholders and shareholders with tied voting rights representing over 5% of the total voting rights in the notes to the annual report. If the articles of incorporation stipulate a lower percentage limit for the purpose of transfer limitation, the notification obligation will apply above this limit (Art. 663c para. 2 CO).

Pursuant to Art. 716b para. 2 CO shareholders and company creditors who give evidence of an interest which deserves to be protected are entitled to seek written information about the organisation of the management. Information on this point will be found in practically all the annual reports of Swiss companies, although to differing degrees (Art. 696 CO).

Criticism/benchmarks

The increasing importance of corporate governance questions has turned the spotlight on the demand for disclosure of the Board and management structures of listed companies. On the model of the Anglo-Saxon "comply or explain" principle, the requirement is for compliance with habitual standards to be confirmed or departures from them explained.

The non-public nature of the share register under Swiss law is also the subject of discussion from time to time. This discussion takes place against the background of the fact that the share registers, for example in the USA[38] and Germany,[39] are in principle open to all shareholders. Swiss institutional investors further complain that the non-public nature of the share register, combined with the fact that the hurdles for placing shareholder proposals on the GM agenda in Switzerland are high, makes shareholding activism on the part of institutional investors expensive and therefore unattractive.

Discussion

Disclosure of the structures of the Board of Directors and management in the annual report is justified by the self-constituting nature of the Board of Directors. It is therefore only appropriate to require companies to provide information on compliance with sensible structure principles or their reasons for not doing so. Today a considerable percentage of companies already provide detailed information on the Board structure, including the Board Committees.

On the other hand, there does not appear to be any urgent need to disclose the organisational rules as these are unquestionably internal documents which in principle contain confidential information about the decision-making process in the Board of Directors and management. Such information must not be made available since it would otherwise be accessible to the competition. On the other hand, the publication on a corporate website of summaries or extracts from organisational rules is conceivable.

The public nature of the share register is contested in Swiss law but is rejected by prevailing theory. When a comparison is made with US law it is important to consider that the American “proxy” system almost necessarily requires equal treatment of the Board of Directors and opposing shareholders already prior to the GM. The Swiss model of physical attendance at the AGM may dispense with this disclosure requirement because the model is based on the assumption that the opposition will have the possibility at the AGM of communicating with the other shareholders. Furthermore, attention must be given to the fact that opening of the Swiss share register would allow the inherently undesirable unregistered shares to grow still further because some investors would desist from registration for data protection reasons. The situation would be different if Swiss companies were to allow comprehensive nominee solutions. That would in turn involve another system change with related problems, e.g. the best way of assuring internal communication between the nominees and beneficial owners (see Section 4.1.6 and 9).

Conclusions

In principle, a transparency directive of the Swiss Exchange deserves our support. However it should be confined to those points which are essential to the assessment of the corporate governance of listed companies.

On the other hand, opening of the share register of Swiss companies is not recommended in the present situation.

38 § 220 Delaware Corporation Law.

39 § 67 para. 5 Corporation Law.

5.3 Further information and inspection rights of shareholders

Art. 697 CO gives each shareholder the right to seek information from the Board of Directors at the general meeting on company matters and information from the statutory auditors on the performance and outcome of its audit. Requests for information must be answered in so far as they are necessary for the exercise of the shareholder rights. They may be refused if they “would endanger business secrets or other interests of the company which deserve to be protected”. More restrictive provisions apply to inspection of the business books and correspondence. This presupposes consent of the general meeting or Board of Directors (Art. 697 para. 3 CO). The exercise of information and inspection rights pursuant to Art. 697 CO is also a prerequisite for making a request for a special audit to the general meeting (Art. 697a para. 1 CO).

Moreover, there is an obligation of strictly equal treatment for the entire information policy of listed companies (Art. 717 CO, Art. 72 para. 3 LR). Exceptions in favour of major shareholders are permitted at best if an assurance can be given that they will not take advantage of insider information.

5.4 Insider information

Art. 161 StGB provides penalties for the use of insider information. So far there have hardly been any legally enforceable sentences in Switzerland. However, the preventive effect of the existence of a punishable offence must not be underestimated. Nevertheless, legal policy matters arise in connection with various different interpretations by the courts of the insider prohibition and the effective pursuit of action against insider offences. In connection with virt-x, questions of the delimitation with UK law and the competencies of the UK authorities will also arise.

Corporate practice in Switzerland implements the prohibition of insider trading by all kinds of appropriate measures. These include special agreements with insiders, e.g. before M&A transactions and also “close periods” before the publication of annual, half-yearly or quarterly figures. This might be emphasised in a Code of Best Practice.

6 Takeover rules

6.1 Public offers and defensive measures

Legal situation/practice

The Swiss Stock Market Law (‘SESTA’) and the accompanying ordinance of the Takeover Board (‘SESTO’) provide for appropriate regulatory control of public offers and takeover bids with a view to the protection of fair trading, equal treatment and effective working of the capital markets. Stock market law seeks to play as neutral a role as possible in this regard. The requirements include the equal treatment of competing offers (Art. 30 SESTA). Art. 29 para. 2 and 3 SESTA limits the possibility of defensive measures by the Board of Directors from the date of publication of an offer. According to Art. 35 SESTA-TB in particular the following transactions are not permitted without the consent of the general meeting:

- sale of “crown jewels” with a value or price of more than 10% of the balance sheet total;
- “golden parachutes“;
- the issue of authorised share capital as a “poison pill”.

Defensive measures which are manifestly in breach of company law are also not permitted (Art. 36 SESTO-TB). The Board of Directors is required to have regard to the interests of the company even in takeover situations. The law on responsibility can be used in particular as a penalty against any breach of the obligation to exercise due care.

Art. 34 SESTO-TB also requires the company to notify to the Takeover Board every individual defensive measure which it intends to employ from the date of publication of the offer. This includes the (inherently permissible) measures taken by the general meeting.

Criticism/benchmarks

In comparison with foreign law, Swiss law seems to have taken a balanced approach to the respective interests of legitimate and non-legitimate protective measures against takeover. The great tolerance shown by US law of defensive measures taken by the Board of Directors does not exist in Swiss law to the same extent (e.g. “poison pills” in the form of share buyback programmes etc.). In comparison with UK law and the proposal for a 13th EU directive, which has since been dropped, Swiss law allows the Board of Directors greater freedom of action.

Discussion

The takeover market plays an undisputable role in Switzerland. It is part of the corporate governance concept of listed companies in which "voice" and "exit"[40] exist with equal rights. On the other hand the balance of interests in this context is naturally disputed. "Potential raiders are a virtue, real raiders a vice" is the ambivalent attitude towards the takeover market in general. The inability of companies to protect themselves against raiders entails the risk of their becoming the plaything of dysfunctional financial interests. The role and permissibility of defensive measures are, among other reasons, defended in the USA with the argument that the Board of Directors must be able to negotiate from a position of strength with the raider when takeovers are attempted so as to achieve the best possible price for shareholders or seek an alternative bidder. Protection deficits of companies against raiders may also have a negative impact on the willingness of the corporate management to make long-term investments or on its readiness to reach long-term strategic interest balances with other stakeholders. At the same time it must be conceded that the same reasons can also be invoked to hide management inefficiencies and a lack of willingness to adjust. The middle road taken by Swiss law must be seen against this background.

Conclusions

In the legal situation as it stands at present there is no need for special legislative measures or recommendations in the form of a Code of Best Practice.

6.2 Mandatory bid

Legal situation/practice

Art. 32 SESTA requires shareholders who either directly, indirectly or by joint agreement with third parties exceed a limit of 33⅓% of the voting rights to make a public offer to all other owners of stock in the company. This offer must correspond at least to the stock market price and must not be more than 25% below the maximum price paid by the bidder for the relevant shares in the past 12 months.

Art. 22 para. 2 or 3 SESTA allows companies to exclude this offer requirement from their articles ("opting out"). If this is done after the stock market listing, exclusion is subject to the reservation of Art. 706 CO. This states that decisions of the general meeting can be contested if they breach the principle of equal treatment or inappropriately limit shareholders' rights or deprive them of such rights (Art. 706 para. 2 CO).

In addition when the Stock Market Law was adopted companies were allowed the possibility of "opting out" unconditionally for a transitional period of two years ("grandfathering", Art. 52 SESTA). A good many companies with majority shareholders made use of this provision, e.g. family companies, subsidiary companies and others.

40 i.e. the possibility for shareholders to express their opinion ("voice") at the AGM or to sell their shares on the stock market ("exit").

Criticism/benchmarks

The unique Swiss "opting out" solution which was the outcome of an intensive debate between politicians and economic interests in the run-up to the adoption of the Stock Exchange Law is questioned by the Swiss Pension Fund Association in its draft corporate governance recommendations. Section 20 recommends a waiver of the "opting out" clause to guarantee equal treatment of shareholders.

The proposal for a 13th EU directive (which has now been abolished) also contained in its final version a mandatory bid obligation which could not have been excluded. In that regard it followed the model of the UK "City Code on Take-overs and Mergers".

US law does not embody the mandatory bid obligation at federal level. The "takeover statutes" of the individual states do, however, make similar provisions in some cases. But the motivations of the individual states in introducing these laws did not reside in the guarantee of equal treatment of shareholders but in the assurance of the broadest possible protection of the Board of Directors against takeovers on incorporation in the state concerned.

Discussion

The purpose of the protection sought by the compulsory offer requirement is to safeguard confidence of minority shareholders in the continuity of existing shareholder structures. By creating an obligation for a new main or majority shareholder to submit a public bid to the other shareholders, the risk of their suddenly finding themselves placed under different control will be minimised (protection of implicit expectations). This knowledge can increase the attractiveness of shares. A negative factor is that the obligation to make an offer can render the shares of the company concerned less attractive to large shareholders. Takeovers also become more expensive because there is no possibility of e.g. acquiring just 51% of the shares in a company. Conversely this may reduce the disciplining effect of the takeover markets on the Board of Directors and company management. That in turn is, in principle, contrary to the interest of the minority shareholders. The mandatory bid obligation may therefore be seen as a mixed blessing from the shareholders' point of view. The flexibility through the possibility of "opting out", permitting the adjustment to specific structural and market conditions of a company, is therefore to be welcomed from the legal policy angle.

The principle of equal treatment derived from company law and transposed into capital market law is therefore a central concept in the implementation of the compulsory offer. The principle of equal treatment is not an axiom of a "quasi-humanistic type" in absolute terms but a simple instrument to protect confidence and expectations of investors and shareholders.

That is why a distinction must be drawn between the "ex ante" and "ex post" exclusion of compulsory offers. From the investor's point of view, exclusion of the mandatory bid before listing does not require any form of regulation. Here the investor knows before making his investment decision that he is purchasing shares which do not carry a compulsory offer obligation. It is then a matter for the market to assess this circumstance. That may result in a price discount. The exclusion of compulsory offers may, however, be more than offset by the special confidence of investors in the majority shareholder. He in turn would perhaps not be willing to invest in the company concerned or to put the company on the stock market if his package of shares carried a compulsory offer obligation. That could destroy substantial potential value gains. The possibility of opting out before listing therefore creates efficiency potentials which would be destroyed by rigid rules. The handover of responsibility for the "opting out" decisions to the capital markets does on the other hand make possible the exploitation of such efficiencies.

The same economic importance attaches to the “grandfathering” rule allowed by stock market law. This too was presented as an “ex ante” solution because it did not destroy any legitimate expectations of minority shareholders as to the existence of a compulsory offer. On the other hand, it did enable the legitimate expectations of previous majority shareholders to be protected.

Greater problems attach to the subsequent introduction of “opting out” solutions. Here action can be taken against the legitimate expectations of minority shareholders. However, the same situation applies with many other decisions in the company, for example capital increases with exclusion of subscription rights. Art. 22 para. 3 SESTA therefore justifiably emphasises the fact that subsequent “opting out” decisions of the AGM are subject to the objectivity requirement of Art. 706 CO and can be contested.

Conclusions

Because of the clear and soundly based legal situation no additional need for regulation or recommendations can be detected.

6.3 Limitation of transfer and other voting right restrictions

All kinds of voting right limitations may also be hurdles to takeovers, e.g. transfer limitation clauses, voting cap clauses or (multiple) voting right shares. Here the situation is similar to that concerning the mandatory bid: a balance must be drawn between the (essentially problematic) potential of such tools as defensive measures against a takeover and the positive flexibility or efficiency aspects of these provisions. If they are established “ex ante” the decision can be left to the capital markets. If they are introduced “ex post” a legal scrutiny of the kind established in Swiss law seems justified (see Section 4.1.7.).

6.4 Cross-shareholdings

Cross-shareholdings are sometimes referred to as a further problem of corporate governance or protection against takeovers. These are not widely used in Switzerland in comparison with the practice in other countries (especially in Asia). This is not an acute problem so that there is no urgent need for a statutory solution (as in the German KonTraG for example[41]). At least the transparency of cross-shareholdings is guaranteed on the basis of Art. 20 SESTA and Art. 663c CO. In this connection attention must be drawn to the fact that the trend of the Swiss economy, apart from mergers and forms of cooperation necessitated by business considerations, is in the direction of unbundling. This applies in particular to banks, whose policy has been clearly directed in recent years towards separation from shareholding interests in companies.

41 § 328 Corporation Law stipulates voting right limitations for companies with mutual shareholding interests.

7 Board of Directors – Executive Management

Preliminary

The Board of Directors under Swiss Corporate Law is a "unitary board". It is therefore similar to the "one tier system" of Anglo-Saxon law and differs from the "two tier system" embodied in German law. The division of functions between the Executive and Supervisory Board reduces the tasks of the latter essentially to a monitoring role. Strategic management necessarily rests with the Executive Board. On the other hand the Anglo-Saxon Board systems are significantly more flexible and leave the company considerable freedom to apportion powers between the Board and the Management. Swiss company law also leaves considerable organisational discretion to the Board. Only the core competences of the Board of Directors listed in Art. 716a CO cannot be delegated upwards, i.e. to the AGM, or downwards, i.e. to the executive management. Powers of the Board of Directors which cannot be delegated and are inalienable include in particular strategic management. In actual fact however the differences from the Anglo-Saxon Board system are unlikely to be significant as the fiduciary duties of Anglo-Saxon Boards also carry an obligation to act in favour of the shareholders in matters of strategic importance to the company.

7.1 Membership of the Board of Directors

7.1.1 Nationality and residence requirements

Legal situation/practice

Art. 708 CO stipulates that members of the Board of Directors must for the most part be persons who are resident in Switzerland and have Swiss nationality. Exceptional authorisations by the Federal Council are provided only for holding companies where a majority of the holding interests are situated abroad.

Criticism/benchmarks

Art. 708 CO is criticised on grounds of protectionism. It is also suggested that this article restricts the inherently desirable international composition of the Board of Directors in big global companies.

Discussion

Art. 708 CO was embodied in corporate law in 1936 and was no doubt understandable at the time. But it is no longer appropriate to the global economy prevailing today. The availability of Board members even in urgent cases is more important than nationality and considerations of residence. The technical facilities available today are quite different from those which existed in the first half of the 20th century. Art. 708 CO should therefore be annulled at the earliest opportunity. The in itself legitimate interest of Switzerland in having members of company bodies who can easily be called to account for social security and withholding tax purposes does not justify this interference with appointment arrangements. The same applies also to the responsibility claims, which are in any case already covered by Swiss jurisdiction (Art. 761 CO).

The existence of Art. 708 CO should not hide the fact that many Swiss companies have a strongly international Board of Directors membership, even in comparison with foreign companies.

Conclusions

Art. 708 CO must be amended when the law is next reviewed. A request to that effect has already been submitted to the Federal Council and might be implemented with the new GmbH law.

7.1.2 Executive and non-executive or independent members of the Board of Directors

Legal situation/practice

The law on listed companies contains no provisions on the composition of the Board with executive (internal) and non-executive (external) or independent Board members. No bylaw provisions on this matter are usual in Switzerland either. In the Swiss tradition the Boards have always consisted primarily of non-executive members, i.e. members who do not perform any immediate management functions in the company. The corporate governance debate has made this practice still more prevalent and led to a situation in which further interlinked interests (e.g. banks, cross-membership of board: "interlocking directors") are being examined in more detail.

Criticism/benchmarks

Under the "Combined Code" of the London Stock Exchange a balance must exist between "executive directors" and "non-executive directors" so that no individual or group is able to dominate the Board.[42] At least one-third of the Board members must therefore be non-executive members.[43] A majority of these non-executive members must also be "independent": "The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement".[44] The concepts of "non-executive" and "independent" are therefore not synonymous: the former is more extensive than the latter.

Since 1956, the New York Stock Exchange has also imposed a requirement for at least two Board members to be "outside directors". In most American businesses non-executive Board members now represent a clear majority. The independence requirement on the other hand applies so far only to members of the "Audit Committee". According to the "Blue Ribbon Report" the following persons cannot be regarded as independent:

- a director being employed by the corporation or any of its affiliates for the current year or any of the past five years;
- a director accepting any compensation from the corporation or any of its affiliates other than compensation for board service or benefits under a tax-qualified retirement plan;
- a director being a member of the immediate family of an individual who is, or has been in any of the past five years, employed by the corporation or any of its affiliates as an executive officer;
- a director being a partner in, or a controlling shareholder or an executive officer of, any for-profit business organization to which the corporation made, or from which the corporation received, payments that are or have been significant to the corporation or business organization in any of the past five years;
- a director being employed as an executive of another company where any of the corporation's executives serves on that company's compensation committee."

42 "Combined Code", A.3.

43 A.3.1.

44 A.3.2.

The New York Stock Market adopted this provision in broad measure but in a slightly diluted form. In particular, a Board member is regarded as independent if his appointment with the company dates back more than three (instead of five) years.[45]

Discussion

The inclusion of non-executive members on the Board of Directors is both functional and appropriate. It should be regarded as a counterbalance to the "agency" problem in the relationship between shareholders and company management. Non-executive Board members are therefore a necessary element of any effective corporate governance.

Another question is whether and if so which requirements are to be placed on the independence of non-executive Board members. Scepticism is appropriate here in relation to all excessively detailed descriptions of the kind contained in the "Blue Ribbon Report". Principles would be more appropriate to the Swiss tradition and approach. Here allowance must be made for the fact that the pool of Board members with the necessary qualifications is not unlimited in Switzerland with its unusually high proportion of big international companies. In the search for Board members "trade offs" must therefore be possible, i.e. reasonable application of the independence criteria should be left to the companies themselves. On the other hand, it is legitimate to expect companies to disclose the interests of non-executive Board members. Where potential dependencies exist the companies might describe how they will counteract this risk.

Conclusions

A Code of Best Practice might emphasise the importance of non-executive or independent Board members and make recommendations to the effect that:

— At least a not-insignificant proportion of the Board must consist of non-executive members of whom some must be independent;
— independence should be defined by stipulating that no significant institutionalised interest links exist with the company.

Further details would have the disadvantage of interfering with the organisational autonomy of the companies and might not do justice to their different structures.

The disclosure of the interests of the non-executive Board members might be regulated by the SWX Transparency Directive. That would include the disclosure of cross links between Board members ("interlocking directors").

45 NYSE Listed Company Manual, Sec. 303.01 (3) (a); newly proposed corporate governance rules by NYSE go much further and require, inter alia, that a majority of the Board be independent, see NYSE Corporate Accountability and Listing Standards Committee, June 6, 2002.

7.1.3 Other aspects

The corporate governance draft of the Swiss Pension Fund Association contains various recommendations on competencies, training, number and tasks of the Board members. Other essentially important aspects from the corporate governance point of view are the composition of the Board (e.g. good mix, “financial literacy” at least for Audit Committee members), limitation of the term of office or age limitations or overall number of Board seats held by a Board member. A Code of Best Practice might deal with such matters.[46] An alternative solution would reside in the disclosure of all the relevant modalities of corporate governance of the company in the annual report including:

- Background and interlocking interests of individual Board members (including other Board seats);
- (Desired) mix and (desired) size of the Board (professional qualifications, independent Board, foreigners, age etc.);
- limitation of term of office and/or age restrictions;
- selection procedure for the nomination of Board members (process; Nomination Committee, selection criteria, etc.).[47]

A specification will have to be given by the planned corporate governance Transparency Directive of the Swiss Exchange. Here the aim should be to reach a rational balance between the interests of shareholders in disclosure and the capital market, legitimate secrecy interests of the companies and data protection or personal security interests of the persons concerned.

46 The Combined Code does this.

47 See also the extensive wish list of the Swiss Pension Fund Association:
– Profile of the Board: desired personal and professional features of Board members, desired mix, desired size
– Selection procedure: conditions for reelection, limitation of term of office
– Number of Board members who were previously members of the Executive Management of the same company
– Procedures for resolving conflicts of interest between multiple Board members
– Numerical limitation of Board seats
– Method of remuneration of Board members
– Information on the shares held by Board and Executive Management members
– Obligations of the Board and its Chairman
– Setting up of Nomination, Compensation and Audit Committees
– Summary of the outcomes of the strategy and risk review
– Reasons for any (permanent) delegation of a Board member as Chairman of the Executive Management
– Summary of the management report on strategy
– Total remuneration paid to the Executive Management including option plans

7.2 Board Chairman/CEO separation

Legal situation/practice

The "Board" system under Swiss Corporation Law permits the separation of supervision and executive management within the framework of the binding powers of the Board pursuant to Art. 716a CO. But, unlike German law, it does not make this compulsory. Exceptions exist only for banks on the basis of the Banking Act.

The practice followed by Swiss companies varies. At present or until recently in such companies as Roche, Novartis, CS Group and Zurich Financial Services the CEO is or was also the Board Chairman. This practice has recently come under fire, at for instance the AGMs of Zurich Financial Services and the CS Group. At the CS Group a formal appointment of the "lead independent director" was therefore made with the emphasis on the fact that he already in effect occupied the same position.

Criticism/benchmarks

The UK "Combined Code" recommends a personal separation between the functions of CEO and Board Chairman.[48] Departures from this rule are possible but must be justified.[49] Most English companies have implemented this separation. The appointment of a "senior independent director" or "independent lead director" is also recommended. His role is stressed especially for companies in which the functions of Board Chairman and CEO are not separated.[50]

In the USA on the other hand, the positions of Board Chairman and CEO are regularly held by the same person. But there are prominent exceptions (until recently at Ford for example). In the USA the fact that the same person is Board Chairman and CEO has not so far raised broad criticism. Institutional investors accept this situation because of the dominance of the independent Board members in the body as a whole and the growing practice of appointing an independent "lead director".[51] Consideration must also be given to the fact that the takeover market and especially legal actions on grounds of responsibility are important features of the "checks and balances" of American businesses which reduce the possible risks arising from having the same person as Board Chairman and CEO.

In Germany the same person cannot as a rule be a member of the Supervisory and the Executive Management, but the Supervisory Board plays a less important role than the Board of Directors in Switzerland. In France too, the position of the PDG (Chairman and Chief Executive) is under review.

The corporate governance draft of the Swiss Pension Fund Association recommends in its Section 14 a separation of the role of Board Chairman and Chief Executive in the interests of the independence of the Board.

48 A.2.

49 A.2.1.

50 Cf. Spencer Stewart, A glance at corporate governance around the world, 1997, p. 21.

51 Spencer Stewart, loc.cit., p. 21 f.

Discussion

From the corporate governance angle a clear separation between the functions of the Board of Directors and the operational management is to be welcomed. This can strengthen independent supervision by the Board of Directors. In addition a separation between supervision and operational management promotes transparency of responsibilities.

On the other hand, dual chairmanship of the Board and the Executive Management can have advantages. Information and decision-making routes can be shortened, paralysing power struggles become less likely and the intermeshing of operational and supervisory decisions is facilitated.

Hence, there is little reason to recommend a rigid rule which would promote a separation of the roles of Board Chairman and CEO. The organisational freedom of the company must be the starting point. But the principle of separation could be recommended as a basic rule. However, dual occupation of the post should remain possible, especially if it can be specifically justified.

The question of the separation of the functions of Board Chairman and CEO must be viewed in the context of the "checks and balances" of a company. Independent Board members and above all an independent "lead director", the absence of takeover hurdles and transfer restrictions or voting cap clauses, or particularly active shareholders may significantly diminish the risks arising from having the same person hold the two positions. Instead of naming the reasons for a dual function it should therefore also be permissible for a company to take measures accepted by the Board to limit the possible risk potential of simultaneous occupation of the two posts.

Conclusions

A Code of Best Practice might start from the principle of organisational freedom of companies and recommend measures to weaken possible conflicts of interests when the two posts of CEO and Chairman of the Board are held by the same person. The Code might also list reasons for plausible deviations from the separation rule, e.g. no takeover hurdles, active large shareholders, a majority of independent Board members and the existence of an independent "lead director" or Vice-Chairman.

7.3 Committees of the Board of Directors

Legal position

Corporate law merely stipulates in Art. 712 CO that the Board of Directors must designate its Chairman and Secretary. Alternatively the appointment of the Board Chairman can also be transferred to the general meeting (Art. 712 para. 2 CO). The law makes no provision for committees. But they are permitted by the authority of the Board to delegate certain powers. For this purpose, a basis in the bylaws is needed together with the adoption of organisational rules by the Board of Directors (Art. 716b para. 1 CO). On the other hand the Board's powers under Art. 716a CO cannot be transferred to committees, i.e. in particular:

- strategic management of the company;
- definition of organisation;
- determination of the accounting system, financial control and financial planning;
- appointment and dismissal of Executive Management members;
- strategic monitoring of Executive Management.

The pressure of the capital markets, the growing awareness of the central importance of effective Board structures and the complexity of Board tasks have contributed to a situation in which Board Committees are playing an increasingly important role in Switzerland. Today most listed companies have committees of this kind. But their number, tasks and membership vary widely. In some companies there is a Board Committee with general responsibility which acts as the link between the Executive Management and the Board as such. An increasing number of companies have also set up specialised Board Committees, in particular "Audit Committees", "Compensation Committees" and "Nomination Committees". The annual reports of the companies increasingly contain information on the membership and tasks of these committees.

Criticisms/benchmarks

The UK "Combined Code" requires the formation of an "Audit Committee",[52] a "Nomination Committee"[53] and a "Compensation Committee".[54] The following rules are recommended for their membership:

- Audit Committee: at least three members who must all be non-executives and a majority of them independent;
- Compensation Committee: all non-executive independent members
- Nomination Committee: a majority non-executives.

These committees are also common in the USA. On the basis of the "Blue Ribbon Report", the SEC calls for an "Audit Committee" composed of independent Board Members. In addition, the "Audit Committee" adopts its own charter, which must be approved by the entire Board and is subject to further detailed requirements.[55]

The corporate governance draft of the Swiss Pension Fund Association recommends the formation of Compensation and Audit Committees (Sec. 16/17) which consist of a majority of independent Board members.

52 D.3.

53 B.2.1.

54 A.5.1.

55 Cf. NYSE Listed Company Manual, Sec. 303.00; the most recent NYSE proposals of June 6, 2002, regulate the "Audit Committee" in even more detail.

Discussion

The formation of committees enables the Board to perform specific supervisory duties more effectively and with greater independence provided that the committee membership is appropriate. The growing size and complexity of companies makes a division of labour within the Board almost inevitable. This enables special knowledge and focused experience to be built up. Committees may therefore contribute to the efficiency, independence and legitimacy of the work of the Board of Directors.

The appointment of an "Audit Committee" is already justified by the complexity of the task of supervising the Executive Management. It also permits close cooperation with the increasingly important functions of Internal Audit, Legal Compliance and Risk Management. With regard to "Audit Committee" membership, a stipulation must be made for none of its members to belong to the operational management. The professional criteria (in particular "financial literacy") must be satisfied.

"Compensation Committees" operate in an environment of rising remuneration for managers with an increasingly complex structure and the need to create confidence on the part of shareholders. "Nomination Committees" guarantee a structured selection procedure for the appointment of new members of the Board of Directors and possibly also of the Executive Management.

When considering Board Committees, allowance must also be made for the fact that differences in the shareholding and management structures of the companies call for a degree of flexibility. For instance, listed subsidiary companies of groups may legitimately share supervisory tasks with the group parent company ("shared services"). This may also justify simplified structures of the Board of the listed subsidiary. "Audit" functions may also be performed by a Board Committee with general responsibility. "Compensation Committees" and "Nomination Committees" can be constituted without problems.

The Advisory Board, which exists for instance in the CS Group, must not be equated with a Board Committee. It has a strictly consultative purpose and no organic function.

Conclusions

A Code of Best Practice could set out recommendations for establishing functional committees of the Board of Directors. The emphasis here would be on the "Audit Committee", "Compensation Committee" and "Nomination Committee".

7.4 Other aspects

7.4.1 Informing members of the Board of Directors

Art. 715a CO grants members of the Board of Directors the right to seek information on all corporate matters (para. 1). At Board meetings, all other members of the Board of Directors and Executive Management are required in principle to provide them with unlimited information (para. 2).

Compliance with the comprehensive information rights of the Board members is a sine qua non for the careful performance of the duties of the Board. It is also a correlation of the liability of Board Members (Art. 754 ff. CO). According to the prevailing legal theory, decisions of the Board which are taken in breach of the rights of Board members to information are null and void (Art. 714 CO).

Swiss Board practice seems to be basically aware of the importance of the rights of the Board to information. Difficulties may arise in cases where confidential transactions such as M&A operations are notified only to a limited circle of participants. In this case too, an assurance must be given that the Board's decision on approval is taken in full knowledge of the facts and the members are given a suitable opportunity to prepare for the discussion. The setting up of a "Board Information System" may also be examined along the lines of the normal "Management Information Systems" (including monthly reports with Cockpit Charts etc.). But a reasonable cost/benefit ratio is essential here.

It is also readily understandable that the Board of a group parent company may be responsible for the group as a whole and therefore have access to all the information of subsidiary companies which are under its uniform supervision.

7.4.2 Exercise of activities

The procedures for Board activities are partly laid down in the law. Art. 710 CO provides for a term of office of three years unless the articles stipulate differently. The term of office for each election must never be more than six years. Art. 715 CO gives each Board member a right to convene meetings of the Board. Finally, Art. 713 CO lays down provisions for decision-making by the Board. All other provisions must be defined in the organisational rules of the Board of Directors. In practice the articles of incorporation frequently contain provisions on this matter.

Topics to be covered by the Code of Best Practice include the terms of office, which must not be too long or too short. Three years appears to be a reasonable period.[56]

56 Cf. "Hampel Report", 3.21.

7.4.3 Conflicts of interest

The prevention of conflicts of interest is basically a task which must be performed by each individual Board member. This task includes disclosure of conflicts of interest to the whole Board and abstention on relevant business items and decisions (no "self dealing"). Responsible handling of insider knowledge is another aspect (see Section 5.4). A permanent conflict of interests should result in rejection of the Board mandate or resignation.

7.4.4 Working methods of the Board of Directors

Recommendations of a general nature (e.g. frequency of meetings, procedure – including minute writing – to enable decisions to be verified after the event, adequate further training, duties of the Bureau etc.) are conceivable but do not appear to be essential.

"Self assessments" by the Board of Directors of the kind used in the USA are acknowledged by the "Hampel Report" as an interesting idea but no particular recommendations are made. The "Combined Code" therefore does not deal with this topic. For a Swiss Code of Best Practice a recommendation is conceivable but not obligatory.

7.4.5 Resignation of Board Members

In the event of early resignation of Board Members the question of disclosure of the reasons arises. The "Hampel Report"[57] recommends at the very least an indication as to whether differences over corporate policy or personal disputes were the decisive factors. If the reasons are purely personal, data protection should prevail. The "Combined Code" says nothing on this matter.

Recommendations on matters concerning the resignation of Swiss Board members is conceivable given the questions which arose in connection with the latest events affecting Swiss companies. They include the issue as to whether and when a Board of Directors should resign en bloc or in a phased manner. This question must be answered in the light of the obligations of the Board of Directors to exercise due care.

57 "Hampel Report", 3.23.

8 Statutory auditors

Legal position

The tasks of the external auditors are covered by Art. 727 et seq. CO. The statutory auditors are elected by the AGM (Art. 727 para. 1 CO). In the case of listed companies a special professional qualification is essential (Art. 727b CO). Auditors must also be independent of the Board of Directors and of any majority shareholders. They must not be employees of the company to be audited nor may they perform work for the latter where this is incompatible with the audit task (Art. 727c CO).

Criticism/benchmarks

The main theme of the corporate governance debate in connection with the function of the statutory auditors is their independence. This may be affected in at least two ways:
1. By close links with the Executive Management through the granting of the mandate or additional functions (e.g. consultancy work and long-standing personal contacts);
2. Through the own interests of the statutory auditors with regard to the generation of further mandates outside the audit mission.

The independence of the statutory auditors is also of interest in foreign countries. The German KonTraG, for example, contains provisions which stipulate that the primary loyalty of the statutory auditors is to the Supervisory Board and that the latter places the audit contract. The American SEC has also taken various steps to assure that the audit mandates of audit companies are clearly separated from their consultancy mandates. In the wake of the "Enron" scandal a lot more is to be expected.

Discussion

The central importance of the independence of the statutory auditors is undisputed. This in itself suggests the desirability of maximum separation of persons and interests between the statutory auditors and the company. The postulate of independence also suggests an essential need for rotation under which either the audit companies or at least the responsible persons within the audit company would have to be changed after a certain period of time. However, such measures may be prejudiced by the fact that close cooperation between the company managers and the statutory auditors generates undoubted efficiencies. Familiarity on the part of the statutory auditors with the corporate circumstances also improves their ability and opportunity to trace problems and gain an overview of the entire corporate situation. Especially for the audit of big companies, there are in addition only a limited number of suitable audit companies (in principle the "big four").

The institutionalised contact with the Audit Committee, which additionally emphasises the importance of this body, may contribute further to the independence of the statutory auditors.

Conclusions

The topic of independence of the “statutory auditors” might be incorporated in the recommendations contained in a Code of Best Practice or a Transparency Directive of the Swiss Exchange, for example by a requirement that the annual report would have to describe how the independence of the statutory auditors is assured. Excessively rigid solutions would have to be rejected here too. Allowance must be made for the fact that the Audit Chamber recently adopted its own directives on independence which point in the same direction.[58] A Code of Best Practice might therefore make reference to them.

58 Directives on Independence, published by the Audit Chamber, Zurich 2001.

9 Institutional investors and intermediaries

9.1 The role of institutional investors

The growing importance of institutional investment capital in recent years has brought about a change in the shareholder paradigm, especially in the Anglo-Saxon countries. The traditionally strong manager/board members now suddenly found themselves confronted with large investors or investor groups which were able to influence the strategic and operational orientation of businesses through both “voice” and “exit”. In the USA a good 60% and in Great-Britain a good 70% of all listed shares are held by institutional investors. But these only make their influence felt to a limited extent through the exercise of their voting rights. There are of course spectacular examples such as the sudden changes at the head of businesses like IBM, General Motors or AT&T. The focussed interventions of Calpers, the Californian Civil Servants Pension Fund, also hit the headline from time to time. Nevertheless, even in the Anglo-Saxon countries it would be wrong to speak of widespread shareholder activism on the part of institutional investors. Or, to put it in the words of one American observer: “There is less to it than meets the eye”.[59]

There has been a paradigm shift in the shareholder landscape in Switzerland too. In our country, domestic and foreign investors certainly play a far more important role than was the case just a few years ago. The shares held in Swiss companies by institutional investors still probably amount on average to less than 50%. Big public companies above all have felt the growing presence of institutional shareholders in recent years. Although this was previously only apparent to a limited degree, for example in 1987 in connection with the introduction of share transfer restrictions at Sandoz and Ciba-Geigy, the market and the political pressure of institutional investors now play a permanent role. This has also enhanced the corporate governance debate in Switzerland. The new role of institutional investors has become clear in connection with various takeover situations (such as Sulzer or Feldschlösschen).

Theoretical studies and empirical data show that active institutional shareholders can contribute to an enhancement of corporate value. Nevertheless, the active long-term commitment of major institutional shareholders is also typified by a degree of reticence in Switzerland. There are plausible reasons for this, such as the fact that the costs of an active commitment must be borne in full by the party concerned while the resulting benefits also accrue to other shareholders (“free rider effects”). Incentive structures as part of the internal organisation of institutional investors may also contribute to a diminished inclination on the part of their representatives to promote long-term shareholder interests actively, e.g. because their personal financial remuneration is determined solely on the basis of short-term financial results. An active commitment, especially if it is linked to a seat on the Board of Directors, may also tie up the shares of an investor – for one thing because insider rules have to be respected. There may then be a trade-off between control and liquidity for institutional investors. Regulatory barriers may also prevent large share packets from being acquired by a particular company (cf. the investment directives in BVV2 applicable to pension funds). Transfer limitation and maximum voting clauses of the companies may have the same effect.

59 Two recent examples of shareholder activism, the change of CEO at Ford and the “proxy fight” at Hewlett Packard over the merger with Compaq were initiated by family shareholders.

9.2 “Agency” problems on the shareholder side

From the corporate governance perspective, the growing role of institutional shareholders must be recognised as a fact. But because institutional investors offer the possibility of increasingly helping shareholder interest to gain the upper hand this development also brings an opportunity. However, it must be borne in mind that institutional investors and intermediaries may themselves be confronted with “agency” problems. In formal terms they are simple shareholders. But if we dig a little deeper we soon find that institutional investors regularly manage money which from the economic standpoint belongs to other persons, e.g. the beneficiaries of pension funds, shareholders in investment companies, investment fund holders and policy holders of insurance companies. The “agency” problem may therefore be shifted from the listed company to the level of its shareholders and their internal representation. The same problem also arises for custodian banks and nominee companies.

For pension funds, investment rules in Swiss law limit the maximum component of equity investments to 30% of the foundation’s assets and the maximum component of individual equity investments to 10% of the foundation’s assets (Art. 54 lit. d BVV2). This does not exclude the acquisition of bigger share packets with voting rights amounting to more than 10% of the company concerned. A degree of control over the representative behaviour by the beneficiaries results from joint membership of the Board of Trustees and in principle also from state supervision (see the example of the Kuoni Foundation). Art. 49a BVV2 also requires occupational benefit schemes to lay down rules for the exercise of shareholding rights.[60] The voting conduct of pension fund managers and their controlling attitude as shareholders is not subject to any other systematic verification by the beneficiaries.[61]

Investment funds are limited in their action as shareholders to the extent that they are allowed to acquire not more than 10% of the votes of an issuer (Art. 39 IFO). No such provisions exist for investment companies which are formed as limited companies. They are not subject to any state supervision whatsoever. The only checks here are the usual statutory rules. Where a shareholder has voting right control over a company he is able to determine the investment strategies of his company without consulting the other shareholders. The only restriction arises from his obligation to exercise due care as a de facto or formal director of the company.

Insurance companies are admittedly subject to state supervision but this does not involve any specific rules for the exercise of voting rights and for the conduct of shareholders in relation to investments in shares. For banks, on the other hand, rules exist for the exercise of voting rights in deposited shares. Here instructions must be sought before a general meeting is held (Art. 689 d CO). No rules of this kind exist for nominee companies.

60 The “Avon letter” of 1988 similarly only imposes general rules on American pension funds in connection with voting rights, e.g. an obligation to exercise share voting rights in the “sole interest of the shareholders”.

61 The Swiss Pension Fund Association is apparently preparing directives for the exercise of the voting rights of pension funds.

From the corporate governance angle the question therefore arises whether the voting conduct of institutional investors with an interest of e.g. 5% should not be subject to special control by the beneficial owners. A recommendation to that effect might in principle be included in a Code of Best Practice. The rules might suggest that e.g. pension funds would always have to arrange for the exercise of their votes and shareholder behaviour to be approved by the Board of Trustees if they propose to act against the wishes of the Board of Directors of a company. For investment companies provision might be made for a reservation of approval by the general meeting if the value of a shareholding amounts for example to more than 20% of the assets of the investment company. For reasons of feasibility it should be possible to give such approval in advance and in a generalised form.[62] Allowance must also be made for the fact that such rules should not unnecessarily promote the undesirable trend towards passive investment strategies from the corporate governance angle.

A special need for action seems to exist for nominee companies. Their growing and meaningful role as links between shareholders and companies demands the assurance of communication with the beneficial owners. Solutions similar to those for custodian banks are conceivable.[63]

Similar questions of communication between formally entitled shareholders and beneficial owners arise in principle with ADRs and similar instruments. In such cases, however, the company does have the possibility of negotiating binding institutional arrangements with the intermediaries who act as nominees (e.g. Bank of New York). This is also done in practice.

62 So as not to dilute the approval requirement completely, maximum time limits such as 18 months would have to apply.

63 A different approach was chosen by US law, which provides for a general obligation for nominees or intermediaries to seek information and instructions, but in “uncontroversial matters” allows votes to be cast without special instructions.

Attachments

Outcome of the consultation procedure

1 General

The parallel consultation procedure on the Swiss Code of Best Practice proposed by the Panel of Experts on Corporate Governance and the "Directive on Information relating to corporate governance" drafted by the Swiss Exchange SWX showed a broad basic assent to the definitive adoption of best practice recommendations on the one hand and a stock market transparency directive on the other. In terms of content too, consensus was achieved on the basic thrust of the two proposals. Nevertheless, the differences in opinion were significant and represent a range of views which had already been voiced in the discussions of the Panel of Experts on Corporate Governance and its committee. However the "main criticisms" were different for the two documents.

2 Proposal for a "Swiss Code of Best Practice"

As expected the following topics were the most controversial:

- "one share – one vote"
- separation of the functions of Board Chairman and CEO
- independence of the Board members
- measures to prevent large numbers of non-voting shares
- degree of detail of the Code

a «One share – one vote»

As had already been the case in the Panel of Experts, a number of institutional investors regretted the fact that the draft did not comment on the question of "one share – one vote". It became clear once again that this concise slogan hides two very different demands. Firstly, the quasi-dogmatic implementation of the principle of parallel capital investment and voting rights without having regard to the differences between "ex ante" and "ex post" discrimination discussed above in Section 4.1.7. Secondly, the more specific attempt to make defensive measures such as share transfer limitations and voting cap clauses more difficult. One proposal was that a periodic justification should be required for the introduction and maintenance of such clauses.

If a recommendation were to be delivered on the principle of "one share – one vote" in the light of the considerations set out in Section 4.1.7, the only real issue could be the further limitation of subsequent voting right discriminations beyond the restrictions already contained in the existing law. The functional aim would be to prevent defensive measures against takeovers which are not in the shareholder's interest. Simple rules could be adopted for this purpose, e.g. a recommendation that the company should give appropriate attention to the impact on the monitoring function of the capital markets when voting right privileges or discriminations are subsequently introduced. The recommendation might suggest that voting right privileges and discriminations should be formulated in such a way as not to impair the controlling function of the capital markets. To be sure, most of the consultation participants did not want to go beyond the existing statutory rules of corporate and stock market law, which were regarded as balanced.

b Separation of the functions of Board Chairman and Chief Executive

The opinions expressed on this topic once again proved very broad, with general recognition of the fact that there are exceptional situations which may justify the same person heading the Board and Executive Management. Opinions which supported the flexibility of the code as defined in Section 7.2 clearly prevailed.

c Independence of Board members

The recommendation embodied in the Code to the effect that a majority of Board members should be non-executives received broad support. Institutional investors in particular wanted to go a step further and require additional independence criteria for Board members. They took issue with the fact that more stringent independence criteria were formulated for Committee members but not for Board members in general. One proposal was that, in addition to the requirement of a majority of non-executive Board members, a stipulation should be introduced to the effect that some of these members should also be "independent" in a more strictly defined sense (e.g. no appointment with the company within three years before election to the Board of Directors and no interlocking links with another Board member belonging to the management).

The fact that the proposed code sets out recommendations on independence for the membership of the Audit and Compensation Committees already amounts to an indirect recommendation that independent members in the narrower sense of the term should be included in the Board of Directors. In principle, it would have been possible to include this recommendation directly, e.g. by stipulating that at least some members of the Board should be independent. The independence criterion defined in the Code might also address interlocking structures in order to create a particular awareness in companies of this aspect. Several participants in the consultation procedure were explicitly opposed, however, to specific independence recommendations for the Board as a whole.

d Measures to prevent large numbers of unregistered shares

The problem of unregistered shares was emphasised in the consultation proceedings because it is visible and constitutes a concrete problem for the companies concerned. Doubts were expressed as to whether the problem of unregistered shares in fact forms part of the corporate governance issue. A good few votes did stress the importance of the recommendation to the custodian banks that they must take measures to enter their customers in the share register. The proposed solution with nominee quotas was also discussed. A broad consensus was reached to the effect that nominee quotas might alleviate the problem of unregistered shares. But attention was also drawn to the consequential problems already mentioned in Section 4.1.6 which would need to be resolved:

— the problem of the anonymization of beneficial owners registered via nominees and
— the problem of involving beneficial owners in the exercise of voting rights by nominees.

In principle, it would be possible to make recommendations on nominee registrations in a Code of Best Practice. However, a clear expression of will in that direction was not evident from the consultation procedures. In addition, satisfactory regulation of nominee registrations also requires an involvement of the legislator, as explained in Section 4.1.6.

e Degree of detail of the Code

The character of the proposed Code as a recommendation issued in the final analysis by private organisations was repeatedly discussed in the consultation procedure. The goal of self-regulation pursued in this case was supported as correct by most participants. On the other hand the degree of detail of the Code was criticised from two sides. One current of opinion saw it as too detailed and suggested that the Code recommendations be published without explanations. An opinion at the other end of the spectrum saw all too many self-evident features in the Code and in the accompanying explanatory statements and would have laid down still more detailed regulations. On the whole, however, the chosen format was supported.

f Further critical points and references

The consultation considered and processed by the committee and the Panel of Experts revealed a great many other critical points and references. They included the following:

Basic strategy

- corporate governance should refer still more emphatically to other stakeholders and not just to shareholders.

Scope of the Code

- The geographical scope of the Code and its applicability to personnel should be defined.

Institutional investors

- The monitoring role of institutional investors should be emphasised more strongly.
- The obligation to include beneficial owners in the exercise of voting rights should be confined to custodian banks and nominees. Investment funds should not be addressed.

The general meeting

- Motions and questions put forward for the general meeting should be discussed only if the author of the motion is present at the meeting (“threshold of seriousness”).
- Global votes should never be taken for Board elections, and in granting “discharge” only if no shareholder expresses opposition.
- Minutes of the AGM should be published within 14 days on the Internet.

Board of Directors/Management Committee

- The statutory term of office of 6 years should not be shortened.
- The corporate strategy can and should be determined only by the Board in cooperation with the Executive Committee.
- The Board should meet at least 6 times a year.
- Every Board member should be able to convene a meeting of the Board (that requirement is already satisfied by Art. 715 CO).
- External consultancy support should be called in only by the Board as a whole and not by individual Board members.
- Nomination committees should also be responsible for the selection of the most senior management members.
- Severance payments should not amount to more than one year’s remuneration.
- Interest conflicts within the Board do not require the assent of the whole Board for their settlement; the consent of authorised signatories will suffice (reference to Swiss Federal Supreme Court Decision/BGE 127 III 332 ff).
- Each year, the Board and Management Committee members should confirm compliance with the insider rules or disclose their transactions in shares of the company immediately after their implementation.

Several detailed proposals were also made on the activity of the Audit Committee, including compliance (e.g. division of tasks between Board/Audit Committee/Management).

3 Proposal for a directive on information on corporate governance

The basic comments on the proposal for a Transparency Directive of the Swiss Exchange related firstly to the justification for such a directive. The question was asked as to whether it was not a task of the legislator to create transparency rules which go beyond the current statutory provisions. It may be objected that Art. 8 SESTA provides authority for the stock markets to issue such prescriptions. The suggestion was also made that the disclosure rules be limited to those areas which are covered by the "Swiss Code of Best Practice". Various disclosure rules (e.g. group holdings of more than 5%, audit fees etc.) came in for some criticism in this context. The main question was whether the idea of disclosure should be embodied in a separate chapter of the annual report. The proposal to make references to statutory provisions and those of corporate or stock market law in the annual report was also rejected.

Many criticisms pointed to a sensible limitation of the facts to be disclosed. In this connection the generally applicable principle of materiality was mentioned favourably again and further emphasised. However, there were also some opinions in favour of extension of the disclosure obligations proposed by the Swiss Exchange. For example, some participants in the consultation advocated individual publication of share and option holdings and also details of remuneration of the Board and Executive Management members. But most participants in the consulation were content with disclosure of overall figures with a breakdown according to membership of executive and non-executive bodies.

The proposed provisions on disclosure of paid or agreed severance grants were also contested. It appeared that as to the type of disclosure (e.g. aggregated with other remuneration of the same person or other persons) further clarification was required. Some participants also wanted more far-reaching provisions, e.g. disclosure of all severance allowances paid out within the last five years or disclosure of remuneration where this amounted to at least one (and not two) year's compensation. Others stressed the confidentiality interests of the company and of the persons concerned. The disclosure of severance arrangements agreed in advance ("golden parachutes") was also called into question. Attention was called to the fact that the two related disclosure provisions in respect of severance arrangements should be better coordinated.

The "comply or explain" principle also gave rise to comments. For example, some people took the view that "disclose or explain" would be more appropriate. However, the need for flexibility was broadly recognised.

Many criticisms, observations and comments were made, e.g. in the following areas:

Scope

— The applicability of the directive to foreign companies with primary listing in Switzerland should be clarified.

Group structure

— The 5% threshold for the disclosure of significant shareholding interests would be too low.

Board/Management

- Board members should also give information about their professional career.
- Management members should also give information about parallel activities outside their work for the company.
- The “independence criterion” for Board members should be separated from the unclear criterion of “no or relatively few business relations with the company” and brought into harmony with the “Swiss Code of Best Practice”.

Change of control/defensive measures

- It would be inherently desirable for “change of control” clauses in important contracts to be disclosed.

Statutory auditors

- The disclosure of audit fees would not contribute greatly to more effective corporate governance.

4 Conclusions

The consultation on proposals for a “Swiss Code of Best Practice” and a Stock Exchange Transparency Directive showed a broad basic consensus. The consultation also enabled a number of points to be clarified and misunderstandings removed. However, experience with the two instruments is bound to raise new questions and perhaps a need for review. Consideration of corporate governance is therefore likely to become an ongoing task in Switzerland, as is already the case elsewhere.

Swiss Code of Best Practice for corporate governance

The Swiss Code of Best Practice for Corporate Governance (hereafter «Swiss Code») was unanimously approved on 25th March 2002 by the Board of Directors of economiesuisse on the unanimous recommendation of the Panel of Experts. The following organizations, which follow closely the topic of corporate governance in the context of their statutory activities, have explicitly endorsed the Swiss Code:

	Date of endorsement
ASIP Swiss Association of Pension Funds Talstrasse 20, 8001 Zurich	25th April 2002
Association of Private Limited Companies St. Jakobs-Strasse 7, Postfach 2879, 4002 Basel	17th April 2002
Confederation of Swiss employers Hegibachstrasse 47, 8032 Zurich	29th April 2002
ethos – Swiss Investment Foundation for Sustainable Development Place Cornavin 2, Case postale, 1211 Geneva 1	29th April 2002
Federation of Swiss Industrial Holding Companies Luisenstrasse 38, Postfach 209, 3000 Berne 6	25th April 2002
SGCI Swiss Society of Chemical Industries Nordstrasse 15, Postfach, 8035 Zurich	6th June 2002
sgv – Umbrella organization of small and medium-sized enterprises SME Schwarztorstrasse 26, Postfach, 3001 Berne	19th April 2002
SwissBanking Swiss Bankers Association Aeschenplatz 7, Postfach 4182, 4002 Basel	22nd April 2002
Swiss Institute of Certified Accountants and Tax Consultants Limmatquai 120, Postfach 892, 8025 Zurich	8th April 2002
Swiss Insurance Association C.F. Meyer-Strasse 14, 8002 Zurich	8th May 2002
Swissmem Kirchenweg 4, Postfach, 8032 Zurich	16th April 2002
Swiss Retail Federation Marktgasse 50, Postfach, 3000 Berne 7	2nd May 2002
Swiss Society of Financial Analysts and Portfolio Managers (SSFP) Feldstrasse 80, 8180 Bülach	9th April 2002

«Corporate Governance» as a guiding principle

Corporate governance encompasses the full range of principles directed towards shareholders' interest seeking a good balance between direction and control and transparency at the top company level while maintaining decision-making capacity and efficiency.

The «Swiss Code of Best Practice for Corporate Governance» as a guideline and recommendation

The Swiss Code of Best Practice for Corporate Governance («Swiss Code») is intended for public limited companies. Certain provisions are addressed to institutional investors and intermediaries. The purpose of the «Swiss Code» is to set out guidelines and recommendations, but not force Swiss companies into a straightjacket. Each company should retain the possibility of putting its own ideas on structuring and organization into practice.

I Shareholders

1 As investors, shareholders have the final decision within the company.

- The powers of the shareholders are defined by statute. They alone are entitled to make decisions with regard to personnel matters at the top company level (electing and granting release to members of the Board of Directors and appointing the company's auditors), the final approval of accounts (annual and consolidated financial statements) and policy on distributions and shareholders' equity (dividends, increase in capital or reduction of capital). The shareholders determine in the Articles of Association the purpose of the company and other key elements and rules. Their approval is required for decisions on mergers, demergers, changes in the Articles of Association and liquidation.
- Shareholders exercise their rights in the General Shareholders' Meeting and have the right to make motions on items prescribed by the agenda. They may also request information on company matters not included in the agenda and, if appropriate, a special audit.
- Institutional investors, nominees and other intermediaries exercising shareholders' rights in their own name should ensure, as far as possible, that beneficial owners may exercise their influence as to how such shareholders' rights are brought to bear.
- Where registered shares are acquired through custodian banks, the latter should invite the party acquiring the shares to apply for registration in the company's Register of Shareholders.

2 The company should endeavour to facilitate the exercise of shareholders' statutory rights.

- To this end the Articles of Association may lower to an appropriate degree the statutory threshold for shareholders to place items on the agenda or to convene an Extraordinary General Shareholders' Meeting.
- If the General Shareholders' Meeting reduces the par value of shares through repayment, the Board of Directors should review whether it would be appropriate to adjust the required threshold (relating to requests to place items on the agenda, convene meetings or, where appropriate, for a special audit to be carried out) to ensure that shareholders' rights are not curtailed.
- The Articles of Association should be available in writing or in electronic form at any time.

3 The company should ensure that the General Shareholders' Meeting is used as a forum for communication so that it is well-informed in discharging its function as the highest corporate authority.

- The Board of Directors should inform the shareholders in such a way that they can exercise their rights in the knowledge of the essential basis of their decisions.

— The company should, when convening meetings, provide concise explanations on agenda items and on motions put forward by the Board of Directors. Requests by shareholders to place items on the agenda and motions made by them should, if received in time, be officially communicated.

4 **The company should facilitate the participation of shareholders at General Shareholders' Meetings by clearly setting dates and time limits well in advance.**

— The Board of Directors should give notice of the date of the next ordinary General Meeting as early as possible.

— The company should give notice of the deadline for shareholders to propose items for the agenda as well as corresponding motions. This date should not be set any further in advance of the meeting's date than necessary.

— If the Board of Directors sets a deadline prior to the General Meeting in order to identify the persons entitled to exercise shareholders' rights, this deadline, both for holders of registered and of bearer shares, should ordinarily be no more than a few days before the date of the meeting.

5 **The organization of the meeting should enable shareholders to make relevant and concise comments on the agenda items.**

— The Chairman should use his[1] powers to ensure that shareholders may exercise their rights. He should conduct the meeting in a balanced and purposefully way.

— In the interest of the efficient running of the meeting the Chairman should take care that there be no rambling, repeated or unnecessarily derogatory statements. He may limit the time allotted to each speaker, if there are numerous requests to speak on the same agenda item.

6 **Arrangements should be made to ensure that shareholders' rights to information and inspection are met.**

— The Chairman should answer questions which are in order and relate to the company or arrange for a competent specialist or the Chairmen of the Board Committees to reply.

— Complex questions or those having a number of different aspects should be submitted to the Board of Directors in writing in sufficient time to allow for a response to be prepared.

— The minutes of the meeting should be made available to the shareholders as soon as possible but not later than three weeks after the meeting's date.

7 **In the General Shareholders' Meeting the will of the majority should be clearly and fairly expressed.**

- The Chairman should implement the voting procedures in such a way that the majority will can be determined in as an unambiguous and efficient a way as possible.
- In the absence of a clear majority, the Chairman should arrange for voting to take place by written or electronic ballot. If voting takes place by a show of hands, shareholders may request votes against the motion and any abstentions to be recorded. The number of such votes cast should be communicated to the meeting.
- The Chairman may arrange for a combined poll to be taken when electing members of corporate bodies or granting release to them, provided no opposition from the shareholders is apparent and there is not a request for a separate vote on one or more individuals.

8 **The Board of Directors should also take steps to contact shareholders in between the General Shareholders' Meetings.**

- The Board of Directors should inform shareholders on the progress of the company also during the course of the financial year.
- The Board of Directors should appoint a position for shareholders relations. In the dissemination of information, the statutory principle of equal treatment should be respected.

II Board of Directors and Executive Management

a Functions of the Board of Directors

9 **The Board of Directors, which elected by the shareholders, is responsible for the strategic direction of the company or the group.**

— The Board of Directors should determine the strategic goals, the general ways and means to achieve them and the individuals charged with management.

— In its planning it should ensure the fundamental harmonization of strategy and finances.

10 **Swiss company law lays down the inalienable and non-transferable primary functions of the Board of Directors.**

— The primary functions are:
1. the ultimate direction of the company and the giving of the necessary directives;
2. the establishment of the organization;
3. the structuring of the accounting system and of the financial controls as well as financial planning, insofar as necessary to manage the company;
4. the appointment and removal of the persons entrusted with the management and representation of the company;
5. the ultimate supervision of the persons entrusted with the management, with regard, in particular, to compliance with the law, the Articles of Association, regulations and directives;
6. the preparation of the annual report as well as the preparation of the general shareholders' meeting and the implementation of its resolutions;
7. the notification of the court in case of an excess of indebtness over assets. (Art. 716a (1) Swiss Code of Obligations)

11 **Subject to the provisions of the Articles of Association the Board of Directors should lay down the powers and responsibilities of the persons in charge of managing the business.**

— The Board of Directors should ensure that management and control functions are allocated appropriately.

— If the Board of Directors delegates management responsibilities to a Managing Director or to a separate Executive Board, it should issue organizational regulations with a clear definition of the scope of the powers conferred. As a rule it should reserve to itself the power to approve certain significant business transactions.

b Composition

12 A well-balanced membership of the Board of Directors should be sought for.

- The Board of Directors should be small enough in numbers for efficient decision-making and large enough for its members to contribute experience and knowledge from different fields and to allocate management and control functions (section 21 ff.) among themselves. The size of the Board should match the needs of the individual company.
- Members of the Board of Directors should be persons with the abilities necessary to ensure an independent decision-making process in a critical exchange of ideas with the Executive Management.
- The majority of the Board should, as a rule, be composed of members who do not perform any line management function within the company (non-executive members).
- If a significant part of the company's operations is abroad, the Board of Directors should also include members having long-standing international experience or members from abroad.

13 The Board of Directors should plan for the succession of its members and ensure that members receive continuing education.

- The ordinary term of office for members of the Board of Directors should, as a rule, not exceed four years. Adequately staggered terms of office are desirable.
- The Board of Directors should plan the succession of its members and lay down the criteria for selecting candidates.
- The Board of Directors should ensure that newly elected members receive appropriate introduction and that Board Members, where required, receive further training with respect to their responsibilities.

c Procedures and Chairmanship of the Board of Directors

14 The Board of Directors should determine the procedures appropriate to perform its function.

- The Board of Directors should, as a rule, meet at least four times a year according to the requirements of the company. The Chairman should ensure that deliberations are held at short notice whenever necessary.
- The Board of Directors should review regulations it has issued at regular intervals and amend them as required.
- The Board of Directors may obtain at the company's expense independent advice from external experts on important business matters.
- The Board of Directors should discuss annually its own and its members' performance.

15 The Chairman is responsible for the preparation and conduct of meetings; the providing of appropriate information is one of his core responsibilities.

— The Chairman is entrusted with conducting the Board of Directors in the company's interest. He should ensure that procedures relating to preparatory work, deliberation, passing resolutions and implementation of decisions are carried out properly.

— The Chairman should ensure in mutual cooperation with the Executive Management that information is made available in good time on all aspects of the company relevant for decision-making and supervision. The Board of Directors should receive, as far as possible prior to the meeting, the well presented and clearly organized documentation; if that is not possible, the Chairman should make the documentation available prior to the meeting allowing, sufficient time for perusal.

— As a rule persons responsible for a particular business should be present at the meeting. Anyone who is indispensable for answering questions in greater depth should be available.

d Dealing with conflicts of interest and advance information

16 Each member of the Board of Directors and Executive Board should arrange his personal and business affairs so as to avoid, as far as possible, conflicts of interest with the company.

— Should a conflict of interest arise, the member of the Board of Directors or Executive Management concerned should inform the Chairman of the Board. The Chairman, or Vice-Chairman, should request a decision by the Board of Directors which reflects the seriousness of the conflict of interest. The Board shall decide without participation of the person concerned.

— Anyone who has interests in conflict with the company or is obligated to represent such interests on behalf of third parties should not participate to that extent in decision-making. Anyone having a permanent conflict of interest should not be a member of the Board of Directors or the Executive Management.

— Transactions between the company and members of corporate bodies or related persons should be carried out «at arm's length» and should be approved without participation of the party concerned. If necessary, a neutral opinion should be obtained.

17 The Board of Directors should regulate the principles governing ad hoc publicity in more detail and take measures to prevent insider-dealing offences.

— The Board of Directors should consider in particular whether appropriate action (e.g. «close periods») should be taken with regard to purchasing and selling securities of the company or other sensitive assets during critical periods, e.g. in connection with take-over projects, before media conferences or prior to announcing corporate results.

e Chairman of the Board of Directors and President of the Executive Management: joint or separate function

18 The principle of maintaining a balance between direction and control should also apply to the top of the company.

— The Board of Directors should determine whether a single person (with joint responsibility) or two persons (with separate responsibility) should be appointed to the Chair of the Board of Directors and the top position of the Executive Management (Managing Director, President of the Executive Board or Chief Executive Officer).

— If, for reasons specific to the company or because the circumstances relating to availability of senior management makes it appropriate, the Board of Directors decides that a single individual should assume joint responsibility at the top of the company, it should provide for adequate control mechanisms. The Board of Directors may appoint an experienced non-executive member («lead director») to perform this task. Such person should be entitled to convene on his own and chair meetings of the Board when necessary.

f Internal control system dealing with risk and compliance

19 The Board of Directors should provide for systems for internal control and risk management suitable for the company.

— The internal control system should be geared to the size, the complexity and risk profile of the company.

— The internal control system should, depending on the specific nature of the company, also cover risk management. The latter should apply to both financial and operational risks.

— The company should set up an Internal Audit function which should report to the Audit Committee or, as the case may be, to the Chairman of the Board.

20 The Board of Directors should take measures to ensure compliance with applicable rules.

— The Board of Directors should arrange the function of compliance according to the specific nature of the company. It may also allocate compliance to the internal control system.

— The Board of Directors should review at least once a year whether the principles of compliance applicable to themselves and the company are sufficiently known and are constantly observed.

g Committees of the Board of Directors

21 The Board of Directors should form committees to perform defined tasks.

— The Board of Directors should appoint committees from amongst its members responsible for carrying out an in-depth analysis of specific business related or personnel matters for the full Board in preparation for passing resolutions or exercising its supervisory function.

— The Board of Directors should appoint the members as well as the Chairman of each committee and determine its procedures. Otherwise, the rules applying to the Board of Directors should apply accordingly to the committees.

— The Board may combine the functions of several committees provided that all their members fulfil the respective qualifications.

— The committees should report to the Board of Directors on their activities and findings. The overall responsibility for duties delegated to the committees remains with the Board of Directors.

22 As regards committee members, particular rules on independence should be applied.

— It is recommended that a majority of the members of certain committees be independent. Independent members shall mean non-executive members of the Board of Directors who never were or were more than three years ago a member of the executive management and who have no or comparatively minor business relations with the company.

— Where there is a cross membership in Boards of Directors, the independence of the respective member should be carefully examined case by case.

— The Board of Directors may lay down further criteria of independence.

Audit Committee

23 The Board of Directors should set up an Audit Committee.

— The Committee should consist of non-executive, preferably independent members of the Board of Directors.

— A majority of members, including the Chairman, should be financially literate.

24 The Audit Committee should form an independent judgement of the quality of the external auditors, the internal control system and the annual financial statements.

— The Audit Committee should form an impression of the effectiveness of the external audit (the statutory auditors or, if applicable, the group auditors), and the internal audit as well as of their mutual cooperation.

— The Audit Committee should additionally assess the quality of the internal control system, including risk management and should have an appreciation of the state of compliance with norms within the company.

- The Audit Committee should review the individual and consolidated financial statements as well as the interim statements intended for publication. It should discuss these with the Chief Financial Officer and the head of the internal audit and, separately, should the occasion warrant, with the head of the external audit.
- The Audit Committee should decide whether the individual and consolidated financial statements be recommended to the Board of Directors for presentation to the General Shareholders' Meeting.
- The Audit Committee should assess the performance and the fees charged by the external auditors and ascertain their independence. It should examine compatibility of the auditing responsibilities with any consulting mandates.

Compensation Committee

25 **The Board of Directors should set up a Compensation Committee.**

- A majority of the Compensation Committee should consist of non-executive and independent members of the Board of Directors.
- The Chairman of the Board respectively the President of the Executive Management should, as a rule, be consulted except when their own remuneration is under review.
- The Compensation Committee should draw up the principles for remuneration of members of the Board of Directors and the Executive Management and submit them to the Board of Directors for approval.

26 **The Committee should see to the defining of a remuneration policy, primarily at top company level.**

- The Compensation Committee should take care that the company offers an overall package of remuneration, which corresponds to performance and the market, in order to attract and retain persons with the necessary skills and character.
- The remuneration should be demonstrably contingent upon sustainable company success and the individual contribution by the person in question. False incentives should be avoided.
- The dilution effect caused by share option schemes for senior managers should be minimized and the conditions for exercising options shall not be modified subsequently in favour of the option holders.
- Contracts of employment with top managers should contain such provisions on termination of employment as are commensurate with market conditions and which protect the company's interest. In case of early termination of a top management contract only such severance compensation should be paid which is either owed due to the contract or which has been negotiated in compatibility with the interests of the company.

Nomination Committee

27 The Boards of Directors should set up a Nomination Committee.

- The Nomination Committee should lay down the principles for the selection of candidates for election or re-election to the Board of Directors and prepare a selection of candidates in accordance with these criteria.
- The Nomination Committee may also be assigned responsibilities in connection with the selection and assessment of candidates for top management.

h Particular circumstances

28 The rules contained in this Code may be adapted to actual circumstances, depending on the shareholder structure and size of the company.

- Companies with active major shareholders (including subsidiaries listed on the stock exchange) as well as small and medium-sized enterprises may adapt or simplify the guidelines. Such companies should implement in their own way an appropriate arrangement for the assessment of the external audit, a functionally efficient internal control system, the remuneration policy for members of the Board of Directors and the Executive Management and the succession policy for the Board of Directors.
- Small and medium-sized companies may assign responsibilities to individuals instead of setting up committees or have the full Board of Directors perform these tasks.

III Auditing

29 The function of the external audit is performed by the statutory auditors elected by the shareholders and, should that be the case, the group auditors.

- The external auditors should discharge the functions assigned to them in accordance with the guidelines relevant to them. They should cooperate in an appropriate way with those in charge of internal auditing.
- Auditors and group auditors should comply with the guidelines on maintaining independence applicable to them.

IV Disclosure

30 The company should disclose information on Corporate Governance in its annual report.

- The SWX Swiss Exchange Directive on information relating to Corporate Governance is applicable with regard to detailed disclosures.

SWX-Directive on Information Relating to corporate governance

Basis Arts. 1, 3 and 64 LR
Decision of 17 April 2002
Entry into force 1 July 2002

1 **Background**
Under the Federal Act on Stock Exchanges and Securities Trading (SESTA), the SWX Swiss Exchange determines what information needs to be published so that investors can evaluate the properties of securities and the quality of issuers. Internationally recognized standards must be taken into account (Art. 8 SESTA). The information to be published includes details on the management and control mechanisms at the highest corporate level of the issuer (corporate governance).

2 **Purpose of the directive**
The directive is intended to encourage issuers to make certain key information relating to corporate governance available to investors in an appropriate form.

3 **Scope**
This directive applies to all issuers whose securities are listed on the SWX and whose registered office is in Switzerland. It also applies to issuers whose registered office is not in Switzerland but whose securities are listed on the SWX and not in their own country.

4 **Information to be published**
The information that is to be published in the annual report is indicated in the annex to this directive.

5 **Clarity and importance**
The publication of information relating to corporate governance should be limited to what is essential to investors, and the information should be provided in an appropriate and comprehensible form.

6 **Place of publication**
Information relating to corporate governance must be published in a separate chapter of the annual report. This chapter may refer to other parts of the annual report or other easily accessible sources of information. References to Web pages should include the appropriate search paths (URLs).

7 **«Comply or explain»**
The information described in section 5 of the annex ('Compensations, shareholdings and loans') must be disclosed absolutely. A comply-or-explain principle applies in the case of other information: if the issuer decides not to disclose certain information, it must give specific reasons for each instance of non-disclosure.

8 Disclosure deadline

The conditions on the balance sheet date constitute the deciding factor in terms of the information that must be disclosed. Important changes occurring between the balance sheet date and the copy deadline for the annual report should be indicated in an appropriate form.

9 Entry into force

This directive enters into force on 1 July 2002. It applies to all annual reports for financial years beginning on 1 January 2002 or later.

Scope and extent of the information relating to corporate governance

1 Group structure and shareholders

The following information on the group structure and the shareholders must be disclosed:

1.1 Group structure

1.1.1 Description of the issuer's operational group structure.

1.1.2 All listed companies belonging to the issuer's group, including the company names, their domiciles, where they are listed, their market capitalization, the percentage of shares held by group companies and the securities' security or ISIN numbers.

1.1.3 The non-listed companies belonging to the issuer's consolidated entities, including the company names, their domiciles, their share capital and the percentage of shares held by group companies.

1.2 Significant shareholders

Significant shareholders and significant groups of shareholders and their shareholdings to the extent that the issuer is aware of them. For issuers domiciled in Switzerland, disclosure must take place in accordance with the information published in the Swiss Commercial Gazette in the year under review under Art. 20 SESTA and the provisions of the Ordinance of the Federal Banking Commission on the Stock Exchanges and Securities Trading. This includes the key elements of shareholders' agreements published in this connection.

1.3 Cross-shareholdings

Cross-shareholdings that exceed 5% of the capital shareholdings or voting rights on both sides.

2 Capital structure

The following information on the capital structure must be disclosed:

2.1 Capital

The amount of the issuer's ordinary, authorized and conditional capital on the annual balance sheet date.

2.2 Authorized and conditional capital in particular

In addition, the following information must be disclosed in connection with the issuer's authorized and conditional capital:

a The maximum increase in authorized or conditional capital and the duration of the authorization period to carry out an increase in capital.

b The group of beneficiaries who have the right to subscribe for this additional capital.

c The terms and conditions of the issue or creation of securities corresponding to the additional capital.

2.3 Changes of capital

A description of the changes of capital that took place within the last three financial years.

2.4 Shares and participation certificates

The number, type and par value of the issuer's shares and participation certificates, including the main features, for example entitlement to dividend payments, voting rights, preferential rights and similar rights, along with an indication of the portion of the ordinary capital which is not paid in.

2.5 Bonus certificates

The number and the main features of the issuer's bonus certificates.

2.6 Limitations on transferability and nominee registrations

2.6.1 Limitations on transferability for each share category, along with an indication of statutory group clauses, if any, and rules on making exceptions.

2.6.2 Reasons for making exceptions in the year under review.

2.6.3 Admissibility of nominee registrations, along with an indication of percent clauses, if any, and registration conditions.

2.6.4 Procedure and conditions for cancelling statutory privileges and limitations on transferability.

2.7 Convertible bonds and options

Outstanding convertible bonds and number of options issued by the issuer or by group companies on securities of the issuer (including employee options, which must be indicated separately), along with an indication of the duration, the conversion conditions or the exercise price, the subscription ratio and the total amount of the share capital concerned.

3 Board of directors

The following information on the issuer's board of directors must be disclosed:

3.1 Members of the board of directors

For each member of the board of directors:

- a Name, nationality, education and professional background.
- b Operational management tasks for the issuer or one of the issuer's group companies (executive/non-executive member).
- c For each non-executive member of the board of directors:
  - — Information on whether he or she was a member of the management of the issuer or one of the issuer's group companies in the three financial years preceding the period under review;
  - — Information on whether he or she has important business connections with the issuer or one of the issuer's group companies.

3.2 Other activities and functions

For each member of the board of directors:

- a Activities in governing and supervisory bodies of important Swiss and foreign organizations, institutions and foundations under private and public law;

b Permanent management and consultancy functions for important Swiss and foreign interest groups;
c Official functions and political posts.

3.3 Cross-involvement

An indication of cross-involvement among the boards of directors of listed companies.

3.4 Elections and terms of office

3.4.1 The principles of the election procedure (total renewal or staggered renewal) and limits on the terms of office.

3.4.2 The time of the first election and the remaining term of office for each member of the board of directors.

3.5 Internal organizational structure

3.5.1 Allocation of tasks within the board of directors.

3.5.2 Members list, tasks and area of responsibility for each committee of the board of directors.

3.5.3 Work methods of the board of directors and its committees.

3.6 Definition of areas of responsibility

Basic principles regarding the definition of the areas of responsibility of the board of directors and the management board.

3.7 Information and control instruments vis-à-vis the management board

The structure of the board of directors' information and control instruments vis-à-vis the issuer's management board such as internal auditing, risk-management systems and management information systems (MISs).

4 Management board

The following information on the issuer's management board must be disclosed:

4.1 Members of the management board

For each member of the management board:
a Name, nationality and function.
b Education and professional background.
c Tasks previously carried out for the issuer or one of the issuer's group companies, if any.

4.2 Other activities and functions

For each member of the Management Board:
a Activities in governing and supervisory bodies of important Swiss and foreign organizations, institutions and foundations under private and public law;
b Permanent management and consultancy functions for important Swiss and foreign interest groups;
c Official functions and political posts.

4.3 Management contracts

Key elements of management contracts between the issuer and companies (or natural persons) not belonging to the group, including the names and domiciles of the companies, the delegated management tasks and the form and extent of compensation for the fulfilment of these tasks.

5 Compensations, shareholdings and loans

The following information must be disclosed on the compensations for and shareholdings of the members of the issuer's management board and board of directors and on loans granted these members:

5.1 Content and method of determining the compensations and of the shareholding programmes

Basic principles and elements of compensations for and shareholding programmes of acting and former members of the issuer's board of directors and management board and basic principles regarding the responsibility and procedure for determining these compensations and shareholding programmes.

5.2 Compensations for acting members of governing bodies

5.2.1 The total of all compensations such as honorariums, salaries, credits, bonuses and benefits in kind (benefits in kind are to be valued according to the market value at the time they were conferred) that were conferred by the issuer or one of the issuer's group companies during the year under review and directly or indirectly benefited members of the board of directors and/or the management board; this also applies to all the members of governing bodies who gave up their functions during the year under review (i.e. who were no longer members on the disclosure deadline).

5.2.2 The amount is to be disclosed in the case of:

- a The executive members of the board of directors and the management board in toto;
- b The non-executive members of the board of directors in toto.

5.2.3 Additional severance payments to the persons mentioned above who gave up their functions in a governing body during the year under review are to be disclosed separately.

5.3 Compensations for former members of governing bodies

5.3.1 The total of all compensations such as honorariums, salaries, credits, bonuses and benefits in kind (benefits in kind are to be valued according to the market value at the time they were conferred) that were conferred by the issuer or one of the issuer's group companies during the year under review and directly or indirectly benefited members of the board of directors and/or the management board who gave up their functions during the year under review.

5.3.2 The amount is to be disclosed in the case of:

- a Former executive members of the board of directors and the management board in toto;
- b Former non-executive members of the board of directors in toto. In each case, the number of beneficiaries must be indicated.

5.4 Share allotment in the year under review

The number of shares of the issuer that were allotted to the following parties in the year under review:

a The executive members of the board of directors, the members of the management board and parties closely linked[1] to such persons, in toto;
b The non-executive members of the board of directors and parties closely linked[1] to such persons, in toto.

5.5 Share ownership

The number of shares of the issuer that were held by the following parties at the time of the disclosure deadline:

a The executive members of the board of directors, the members of the management board and parties closely linked[1] to such persons, in toto;
b The non-executive members of the board of directors and parties closely linked[1] to such persons, in toto.

5.6 Options

Overview of the options on shares of the issuer (including options stemming from synthetic shareholding programmes) that were held by the following parties at the time of the disclosure deadline:

a The executive members of the board of directors, the members of the management board and parties closely linked[1] to such persons, in toto;
b The non-executive members of the board of directors and parties closely linked[1] to such persons, in toto.

In each case, the allotment year, the duration, the subscription ratio and the exercise price are to be disclosed.

5.7 Additional honorariums and remunerations

The sum of the honorariums (e.g., consultancy honorariums) and other remunerations billed to the issuer or one of the issuer's group companies by each member of the board of directors or the management board or parties closely linked[1] to such persons for additional services performed during the year under review in the case of sums exceeding half of the ordinary remuneration of the member in question.

5.8 Loans granted by governing bodies

5.8.1 The total amount and conditions of the guarantees and outstanding loans, advances or credits granted to members of the board of directors or the management board or parties closely linked[1] to such persons by the issuer or one of the issuer's group companies.

5.8.2 The amount is to be disclosed in the case of:

a The executive members of the board of directors, the members of the management board and parties closely linked[1] to such persons, in toto;
b The non-executive members of the board of directors and parties closely linked[1] to such persons, in toto. In each case, the number of beneficiaries must be indicated.

1 «Closely linked parties» are natural persons and legal entities pursuant to Art. 678 CO.

5.9 Highest total compensation

Without providing any names, the compensations and share and option allotments must be disclosed separately (according to Arts. 5.2, 5.4 and 5.6 respectively) in the case of the member of the board of directors upon whom the highest total compensation (according to Arts. 5.2, 5.4 and 5.6) was conferred in the year under review.

6 Shareholders' participation rights

The following information on the participation rights of the issuer's shareholders must be disclosed:

6.1 Voting-rights restrictions and representation

6.1.1 All voting-rights restrictions, along with an indication of statutory group clauses and rules on making exceptions, particularly in the case of institutional voting-rights representatives.

6.1.2 Reasons for making exceptions in the year under review.

6.1.3 Procedure and conditions for cancelling statutory voting-rights restrictions.

6.1.4 Statutory rules on participating in the general meeting of shareholders if they differ from applicable legal provisions.

6.2 Statutory quorums

Resolutions of the general meeting of shareholders which, under the issuer's articles of association, can only be carried by a majority greater than that set out by applicable legal provisions, along with an indication of the size of the majority for each case.

6.3 Convocation of the general meeting of shareholders

Statutory rules on the convocation of the general meeting of shareholders if they differ from applicable legal provisions.

6.4 Agenda

Rules for adding items to the agenda of the general meeting of shareholders, especially rules on deadlines.

6.5 Registrations in the share register

Rules on the deadline for registering holders of registered shares in the issuer's share register in connection with attending the general meeting of shareholders, as well as rules on making exceptions, if any.

7 Changes of control and defence measures

The following information on changes of control and defence measures must be disclosed:

7.1 Duty to make an offer
Existence of statutory rules on opting out or opting up (SESTA Art. 22), along with an indication of the threshold in percent.

7.2 Clauses on changes of control
Content of clauses on changes of control in agreements and plans benefiting members of the board of directors and/or the management board and/or other members of the issuer's cadre (e.g., golden parachutes).

8 Auditors

The following information on the auditors must be disclosed:

8.1 Duration of the mandate and term of office of the head auditor
8.1.1 Date of assumption of the existing auditing mandate.
8.1.2 Date on which the head auditor responsible for the existing auditing mandate took up office.

8.2 Auditing honorarium
The total of the auditing honorariums charged by the auditors in the year under review.

8.3 Additional honorariums
The total of the honorariums charged in the year under review by the auditors and parties associated with them for additional services (e.g., management consulting) performed for the issuer or one of the issuer's group companies.

8.4 Supervisory and control instruments vis-à-vis the auditors
Composition of the board of directors' supervisory and control instruments vis-à-vis the external auditors.

9 Information policy

The following information on the issuer's information policy must be disclosed:

The frequency with which and form in which the issuer provides its shareholders with information, along with an indication of permanent sources of information and contact addresses of the issuer that are publicly accessible or made specially available to shareholders (e.g., links to Web pages, information centres, printed matter, etc.).

Panel of Experts on Corporate Governance

- ABB Ltd., Zurich
- Alcan Holding Switzerland AG, Zurich
- ASIP – Swiss Association of Pension Funds, Zurich
- Bâloise Holding, Basel
- Bühler AG, Uzwil
- Ciba Speciality Chemicals AG, Basel
- Clariant International Ltd., Muttenz
- Credit Suisse Group, Zurich
- Ethos – Swiss Investment Foundation for Sustainable Development, Geneva
- F. Hoffmann-La Roche AG, Basel
- Georg Fischer AG, Schaffhausen
- Lombard, Odier & Cie., Geneva
- Lonza Group AG, Zurich
- Nestlé SA, Vevey
- Novartis International AG, Basel
- Rieter Holding AG, Winterthur
- Schindler Holding AG, Hergiswil
- SwissBanking Swiss Bankers Association, Basel
- Confederation of Swiss employers, Zurich
- Swiss Society of Financial Analysts and Portfolio Managers (SSFP), Bülach
- Swiss Insurance Association, Zurich
- SGS Société Générale de Surveillance Holding SA, Geneva
- Swiss Banking Institute, University Zurich, Zurich
- Swiss Re, Swiss Reinsurance Company, Zurich
- Swiss Retail Federation, Berne
- Swissca Holding AG, Berne
- SwissCham, Zurich
- Swissmem, Zurich
- SWX Swiss Exchange, Zurich
- Swiss Institute of Certified Accountants and Tax Consultants, Zurich
- UBS AG, Zurich and Basel
- Association of Private Limited Companies, Basel
- Federation of Swiss Industrial Holding Companies, Berne
- Versicherungskasse der Stadt Zürich, Zurich
- Zurich Financial Services, Zurich

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