Both public and private businesses must live up to certain standards of corporate governance: either because financial institutions scrutinise the corporate governance of borrowers in more detail or to gain the confidence of investors or for the simple reason that transparent and efficient corporate governance measures are necessary to avoid mistakes and failures. When there is a complete breakdown in the relationship between owners (principals) and management (agents), then corporate governance becomes of particular importance.

An empirical study on corporate governance in Switzerland conducted by the University of Basel reconfirms that good corporate governance has a positive impact on firm valuation. Other studies show that institutional investors are willing to pay a premium for shares of companies with a good standard of corporate governance. Despite this positive correlation between governance and value, Switzerland has witnessed several examples of poor corporate governance. Swissair, Kuoni, Swiss Life and Erb – to name a few – triggered lively discussions and significantly increased the public awareness of corporate governance in Switzerland.

Listed companies had to comply for the first time with the Corporate Governance Directive of the SWX Swiss Exchange (SWX) regarding the annual reports for the financial year beginning on January 1, 2002 or later had to explain the reasons for their non-compliance. A recent comprehensive study conducted by the University of Zurich on behalf of the SWX showed good overall compliance with the new directive in general, but also revealed weaknesses and made valuable suggestions for improvement.

Regulatory framework in Switzerland
The sources for corporate governance regulations in Switzerland are threefold. The Corporate Law of the Swiss Code of Obligations (CO) as well as the Federal Act on Stock Exchanges and Securities Trading (SESTA) provide the general rules and principles applicable to all companies.

Sources of corporate governance regulations

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and public companies respectively. For listed companies, corporate governance standards are contained in the self-regulation of the SWX. The umbrella association of Swiss businesses, economiesuisse, took the initiative and issued the “Swiss Code of Best Practice”, a set of best practice rules recommended for larger companies.

Swiss law in the field of corporate governance relies to a large extent on self-regulation, mainly by the SWX. The codified rules in the law are rather rare and of general nature. Self-regulation allows for swift and efficient adaptation of the rules to new circumstances. Transparency requirements based on self-regulation have proved in practice to be an efficient way to highlight corporate governance matters. The sensitivity of the market automatically and sufficiently protects many of the governance interests.

Swiss Code of Obligations (CO)\(^5\)

The CO contains the corporate governance rules for stock corporations, the vehicle commonly used for business in Switzerland\(^6\). The CO defines in detail the rights of the shareholders, the duties and powers of the board of directors and the role of the statutory auditors, and provides for minimal financial reporting requirements. A group of high level experts was mandated to examine the compatibility of Swiss company law with corporate governance principles. In September 2003, the group delivered its final report to the government and made several recommendations to improve the transparency and shareholders’ rights for all companies and to adapt the corporate governance rules applicable for non listed larger companies to the ones for listed companies\(^7\).

Generally, Swiss company law is compatible with EU law, particularly since its overall reform in 1992. Most of the relevant EU directives in the field of company law and corporate governance were incorporated into Swiss law on an independent basis\(^8\). However, Swiss company law also contains certain material and, in practice, important differences to EU law\(^9\). In particular, the transparency requirements and the financial reporting standards for non listed companies are not in line with EU standards. Swiss company law does not require a “true and fair view” in financial reporting and still allows for hidden reserves and earnings for non-listed companies\(^10\). Foreign investors should take this into consideration when examining investments in Switzerland.

Federal Act on Stock Exchanges and Securities Trading (SESTA)\(^11\)

The SESTA among others contains principles for the organisation and supervision\(^12\) of stock exchanges. With regard to corporate governance, it generally regulates the reporting requirements and public takeover duties. Based on the SESTA, the SWX issued various self-regulations. Corporate governance rules can be found in the listing rules, in the SWX directives and also in the SWX circulars regarding disclosure of price sensitive information (ad hoc publicity) and significant shareholders/shareholdings.

SWX Corporate Governance Directive (DCG)\(^13\)

As already set out, SWX listed companies have to disclose key information relating to corporate governance as part of their annual report based on the DCG\(^14\). A “comply-or-explain” principle applies, with the exception of certain mandatory information on compensation, shareholdings and loans.

A study conducted by the University of Zurich on behalf of SWX\(^15\) regarding the quality of the disclosed information showed a good overall implementation level of the DCG (85%). The detailed analysis of the annual reports of 265 SWX listed companies showed a substantial improvement compared with the reports of the previous year. The fact that corporate governance information had to be disclosed according to a common structure, and separate from the annual report figures, significantly increased the comparability and transparency of the information. Companies generally chose to disclose, rather than explain non-disclosure. A major improvement could be achieved in relation to the disclosure of the compensation and independence of directors, even though the DCG does not prescribe individual, but only overall, disclosure of management and board members.

The study reveals some interesting statistical information: the average compensation awarded to all executive board and management members of the analysed listed companies amounts to SFr4.4m. in total; the average highest compensation awarded to a single executive board member to SFr0.8m. On average, companies paid SFr1.3m. for audit services and SFr1.2m. for non-audit services of audit companies.

Proposed SWX Directive on Directors Dealings (DDD)\(^16\)

In fall 2003 the SWX Admission Board proposed new rules on the obligation to disclose management transactions of listed companies. Generally, transactions must be disclosed according to Art. 20 SESTA if the following thresholds are reached by the sale or acquisition of shares: 5%, 10%, 20%, 33%, 50% or 66%. The proposed new directive, to be published in the final version in the first quarter of 2004, requires additional transparency for “directors’ dealings” of members of the board of directors and of the
management board of listed companies. All transactions in financial instruments of the company to which they belong, carried out directly or indirectly and exceeding a threshold of SFr100,000, should be reported to the company within four exchange days. The company is then required to forward the report to SWX, within two exchange days, for publication on the SWX website. Only an indication of the position of the person concerned, but not their name, is published.

**Swiss Code of Best Practice (SCBP)**

The SCBP was promulgated by a panel of experts in the field of corporate governance and unifies all the efforts to codify corporate governance in Switzerland. The SCBP contains 30 short best practice recommendations and is meant for public and large private companies. The SCBP focuses on the board of directors and the executive management, its organisation, its composition and committees.

**Selected governance issues**

Some selected corporate governance issues are highlighted below that might be of interest for a foreign investor.

**Rights of shareholders**

**General meeting of shareholders**

As the owners of the company, shareholders have the final decision within the company. Private and public companies are required to hold an annual general meeting of shareholders within six months of the close of the business year. Shareholders representing 10% of the share capital or shares with a nominal value of SFr1m can request the convening of a general meeting and ask for items to be added to the agenda. To facilitate shareholders’ participation, lower thresholds can be specified in the articles of association.

The board of directors must serve notice of the general meeting at least 20 days in advance and provide the shareholders with specific information regarding the agenda items and motions, if any. It should be noted that the new Swiss Merger Act on the one hand prescribes additional shareholder information for mergers, spin-offs and transformations and on the other hand prescribes a 30 or even 60 day shareholder examination period before general meetings. Listed companies usually keep shareholders with professional investor relations continuously informed.

Every shareholder may ask the board for information on business matters, exercise its rights in the general meeting and propose motions on items on the agenda. Shareholders can request a special audit for an in-depth analysis of specific issues and make board members and other officers liable for mismanagement.

Companies, whether listed or not, should use the general meeting as a communication platform to build up the confidence of the shareholders. This means that the board should be well-prepared and inform shareholders in a proactive and transparent manner.

**The use of electronic communication between public companies and shareholders**

Adopting the trend in the US, the internet is also being used as a means of communication between public companies and their shareholders. Use of the internet for shareholder communication purposes is possible within the framework of existing company law. There are, so far, no particular regulations for the use of electronic means. The provisions of the CO allow neither fully-fledged shareholder voting over the internet nor the holding of a virtual annual meeting. Hence, most public companies use the internet only for giving notice of the annual general
fiduciary board members are commonly used. There are exceptions to these nationality and domicile requirements for holding companies.

Organisation of the board

The board is generally self-governing and many different board structures exist. However, in Switzerland a unitary board structure prevails as opposed to a two tiered structure24. Swiss law allows the same person to be both the chairman of the board and the managing director/CEO25. Normally, a board consists of a chair and vice-chairman, a secretary26 and regular members.

The board of directors should be small enough in number for efficient decision-making and yet large enough for its members to contribute experience and knowledge from different fields and to allocate management and control functions among themselves. The SCBP recommends that the board and committees be composed of a majority of independent non-executive members. The size and composition of the Board should both match the needs of the individual company and also guarantee the necessary know-how and abilities. Listed companies in Switzerland have an average of seven members on their board of directors and five members on their management board. Almost 90% of the board members are non-executive members, 20% are non-Swiss and only 4% are women.

Committees

The SCBP recommends that the board should appoint committees for defined tasks27. However, there is no legal requirement for committees under Swiss law. The articles of incorporation need to allow the board to delegate certain functions to third parties, e.g. to committees, by establishing organisational regulations. Committees can either have full autonomy over certain business related or personal matters of the company, or only preparatory, executive or supervisory functions on behalf of the board. Committees should be created mainly for reasons of efficiency, independency and professionalism.

Two thirds of the listed companies in Switzerland work with committees. More than 50% have an audit committee and several companies have compensation, nomination and executive committees.

Liability

Members of the board of directors have to perform their duties personally and with due care. Moreover, they have a duty of loyalty, hence should always serve the company’s interests and should treat shareholders equitably. Board members can be held personally liable by shareholders, creditors and the company, both for intentional and for negligent
misconduct. Premiums for directors’ and officers’ insurances in general are rather high and therefore, it tends to be mainly the larger companies that insure the liability of their directors.

**Compensation and disclosure**

The compensation of board and management members is determined by decision of the board of directors. The SCBP recommends the appointment of a compensation committee to determine a remuneration policy for the board and top management. Compensation in general should be contingent upon company success and individual performance and termination provisions and packages should be compatible with the interests of the company.

Based on the DCG, listed companies must disclose the criteria and methods used to determine the compensation and the basic principles and elements of compensation and shareholding programmes for the members of the board and the executive management. The total of all compensation must be disclosed, as well as the number of allotted shares and options on shares, the amount and conditions of any loans granted to board and management members, and the highest total compensation, etc. For the time being, there is no requirement for individual disclosure by each board and management member. However, a project to amend company law and to impose a duty to disclose on an individual basis for all board, but not executive, management members, was proposed.

**Audit**

The function of the external audit is performed by the statutory auditors and, where applicable, the group auditors, both being elected by the general meeting of shareholders. The external auditors must discharge the functions assigned to them in accordance with the guidelines relevant to them, in particular independence requirements. Auditors have to cooperate in an appropriate way with those in charge of internal auditing.

Even though larger companies regularly install internal control systems, no legal requirement exists under Swiss law to establish internal control systems for disclosure and financial reporting.

**Notes:**

2. The unexpected breakdown of the Erb-group was the biggest collapse in Switzerland since Swissair; Erb was 100% family owned.
3. Studie zur praktischen Umsetzung der Corporate Governance-Richtlinie, SWX Swiss Exchange and Institut für Rechnungswesen und Controlling of the University of Zurich, Zurich 2003.
6. Art. 602 et seq. CO; in Switzerland there are app. 170,000 stock corporations but only 55,000 limited liability corporations.
8. Lately the Third EU Company Directive on Mergers (78/855/EEC) and the Sixth Company Directive on Spin-offs (82/891/EEC) were incorporated in the new Swiss Merger Act that will come into force on July 1, 2004. However, certain material and interesting differences still exist between Swiss and EU law.
10. For listed companies, however, the “true and fair view” principle applies, see Art. 66 SWX listing rules.
12. Supervisory authority is the Swiss Federal Banking Commission.
14. See scope and extent of information to be disclosed in the Annex to the DCG.
15. See footnote no. 5.
18. See Art. 698 CO.
19. See footnote nr. 9 above for more details.
20. Art. 16.1, art. 41.1, 63.1 Federal Merger Act (available in English on www.amcham.ch/publications/m_obligations.htm#swiss_merger_law).

22 Art. 716a CO.

23 Art. 708 CO.

24 The common structure of boards of German stock companies.

25 As much as 21% of the listed companies provide for such a structure.

26 The secretary must not be a member of the board (e.g., an external attorney).

27 Recommandation 21 et seq. SCBP.

28 As requested by the Sarbanes-Oxley Act in the US.