



## New Corporate Governance Rules in the United Kingdom: Food for Thought for Swiss Listed Companies

On May 28, 2010, the UK Financial Reporting Council (the **FRC**) announced changes in the UK Corporate Governance Code (the **Code**), formerly known as the Combined Code. The Code is designed to make corporate boards more effective and more accountable to shareholders.

The provisions of the Code have no direct effect on Swiss listed companies. Nevertheless, the principles set out in the Code may eventually have an impact on what Swiss boards consider best corporate governance practice.

### Background

The first version of the UK Code on Corporate Governance was produced in 1992 by the Cadbury Committee. At the time, Switzerland had just overhauled its corporation law, after a legislative process that lasted almost thirty years. Governance standards of Swiss listed companies continued to be quite opaque even after the corporation law reform. Accounting rules applicable to Swiss listed companies did not follow the "true and fair view" principle. The reform of 1992 provided for the disclosure of substantial shareholdings on an annual basis, but only to the extent significant shareholders were known to the company; the shareholders themselves were not subject to any transparency obligations. Rules on public takeover offers did not exist at all. In brief, in terms of corporate governance, there existed a wide gap between Switzerland and the Anglo-Saxon world.

Fast-forward some twenty years and the gap has narrowed to the point of being largely irrelevant. Swiss corporate governance standards satisfy the most rigorous scrutiny of corporate governance pundits and financial analysts alike. Changes in statutory law, recommendations for listed companies set out in the Swiss Code of Best Practice for Corporate Governance, and voluntary compliance by major Swiss listed companies have created a corporate governance environment that is comparable in every manner to the UK model.

Today, Swiss companies listed on the main board of the SIX Swiss Exchange must render their accounts under International Financial Reporting Standards (IFRS) or U.S. GAAP. Substantial shareholders of Swiss listed companies are subject to stringent disclosure obligations starting at 3% of the voting rights, and the disclosure rules apply to derivatives transactions as well. Takeovers are regulated under the

Swiss Stock Exchange Act and are subject to scrutiny by the Swiss Takeover Board. Finally, boards of directors of Swiss listed companies follow international standards in terms of board composition and independence, committee structures and roles, and boardroom routines.

All in all, Switzerland is on the forefront of best corporate governance practice. That said, Swiss directors and their corporate secretaries are used to looking beyond national borders for inspiration. New developments in the international corporate governance arena are carefully analyzed in Switzerland and, if considered useful, implemented locally as well.

## New UK Governance Standards

The UK Corporate Governance Code sets out standards of good practice, in particular on board composition and development; remuneration; accountability and audit; and relations with shareholders. UK listed companies are required either to follow the recommendations set out in the Code or to explain in their annual reports how else they are promoting good governance (a principle known as “comply or explain”).

As noted, the first version of the Code was published in 1992. Thereafter, the Code was reviewed several times, last in 2005 and 2007. The financial crisis of 2008 triggered an extensive debate, in the UK and internationally, relating to the effectiveness of governance systems in the financial sector. As a reaction to this crisis, the FRC promulgated a new edition of the Code which was published on May 28, 2010 (*see* [www.frc.org.uk/corporate/ukcgcode.cfm](http://www.frc.org.uk/corporate/ukcgcode.cfm)). The revised recommendations set out in the Code will generally apply to UK listed companies from the financial year 2011.

## Some recommendations of the Code—and what they mean for Swiss listed companies

As noted, the Code does not apply to Swiss listed companies. Remarkably, though, the Code contains many recommendations – some of them old, some

new – that address topics which are also relevant in the Swiss corporate governance debate.

The most recent changes to the Code include the following:

- *Board composition:* the Code introduces new principles regarding the composition and selection of the board in order to prevent “group think”. The Code emphasizes the need to appoint members on merit, against objective criteria, and with due regard for the benefits of diversity, including gender diversity. The recommendations of the Code fall well short of other approaches, such as Norway’s now famous requirement that 40% of the board members must be female.

In Switzerland, the prevailing view in many boardrooms suggests that a board must first and foremost be professional; other characteristics, such as independence and diversity, are often trumped by the first goal. The future will show whether all objectives can be aligned.

- *Board term:* the Code states that directors of FTSE 350 companies should be put forward for re-election every year. The requirement for annual re-election also applies to non-executive directors who have served on a board for more than nine years.

In Switzerland, the requirement for annual re-election of directors is part of the legislative debate on corporation law reform which is currently taking place. The Federal Council, the executive branch of Swiss government, had proposed mandatory one-year terms, but the proposal was disputed in the parliamentary debate. The odds are out on this issue.

- *Duties of directors:* the Code enshrines new, though somewhat unspecified, principles relating to the leadership of the Chairman, the responsibility of non-executive directors to pro-

vide constructive challenge, and the time commitment expected of all directors.

The topic is known in Switzerland as well, in particular the question how much time a non-executive director needs to spend in order to be able to responsibly fulfill his or her role.

- *Risk strategy:* the Code recommends that the board should be responsible for determining the nature and extent of the significant risks a company is willing to take. This focus on risk, and the role of the board in determining the risk appetite of a listed company, is a clear consequence of the financial market near-meltdown in 2008.

This change will not come as a surprise to Swiss directors. Swiss statutory law holds already today that the ultimate direction of the business of the corporation, as well as the administration of financial control, is a non-delegable duty of the board of directors. Clearly, significant risk decisions are part of these non-delegable duties.

- *Compensation issues:* the Code envisages that performance-related pay should be stretching and designed to promote the long-term success of the company. Particularly, the revised Code is skeptical of option-based remuneration. Again, this change is designed to curb what is considered, with the benefit of hindsight, as the excesses of the pre-financial crisis corporate landscape.

In Switzerland, the debate on compensation is ongoing. "Say on pay", curbs on bonuses in the financial services industry and other topics are in the midst of the corporation law reform which is currently before the Swiss parliament. Also, the Financial Market Supervisory Authority (**FINMA**) has issued minimum standards for remuneration schemes of financial institutions.

- *Board reviews:* the Code suggests that the Chairman should hold regular development reviews to help enhance the board's performance and awareness of its strengths and weaknesses.

Many Swiss companies already do so today.

Other rules in the Code, which already formed part of earlier versions, continue to appear striking to a Swiss reader, and resonate the corporate governance debate that has been going on in Switzerland for the past years:

- *Independence requirements:* the Code assumes that a director can be considered independent if he has not been an employee of the company for at least five years, has had no material business relationship for the last three years, and has no family ties, ties to major shareholders or cross-directorships with other directors. Interestingly, a director is no longer considered independent if he has served on the board for more than nine years.

The latter principle is alien to Swiss listed companies. The Swiss Code of Best Practice for Corporate Governance does state, however, independence requirements similar to those in the UK Code with respect to board committees. Most Swiss listed companies follow the Swiss Code's recommendations.

- *Dual role of Chairman and CEO:* the Code says roles of Chairman and chief executive should not be exercised by the same person. Also, a chief executive should not go on to the Chairman of the same company.

While there is no rule to this effect in Switzerland, the number of single-head companies is getting ever smaller, and those who still have such a governance structure are often under particular public scrutiny. On the other hand, it still occurs fairly frequently that a CEO moves on to become Chairman.

- *Senior independent directors:* the Code proposes that the board should appoint a senior independent director who acts as a sounding board for the Chairman.

Senior independent directors are few and far between in Switzerland.

- *Independent advice:* the Code regards it as necessary that the board ensures that non-executive directors have access to independent advice at the company's expense.

This is a fairly recent development that can also be observed in Switzerland.

- *D&O insurance:* the Code holds that a listed company should arrange appropriate insurance cover in respect of legal action against its directors.

While this has become a widespread practice in Switzerland, the development is fairly recent: some ten years ago, many Swiss corporate boards refused to enter into D&O insurance arrangements because they considered them to cause a moral hazard to directors.

- *Shareholder communications:* the Code encourages a dialogue with shareholders based on the mutual understanding of objectives. The Chairman should particularly ensure that the views of shareholders are communicated to the board as a whole.

Chairmen in Swiss companies almost always have an intense dialogue with their key shareholders; it varies from company to company, though, whether this dialogue is also carried into the boardroom.

## What's in it for Switzerland

While the UK Corporate Governance Code does not apply to Swiss listed companies, the principles and recommendations set out in the Code are reflective of a similar development in Switzerland. They may, therefore, become the object of open debate in Swiss boardrooms and in the legislative process.

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