

Recent corporate governance reforms in Switzerland

by Markus T. Schweizer, Ernst & Young Ltd., Zurich / Switzerland¹

In 2005, Switzerland has seen some of the most significant corporate governance reforms of the last decade. The long-standing tradition of self-regulation has come to an end for the audit profession. Companies in general face an increased pressure to strengthen their risk management processes and systems of internal control. For insurance companies in particular, corporate governance requirements and supervision have caught up with banks and, in certain cases, exceed their requirements. And the next wave of corporate governance reforms is right ahead.



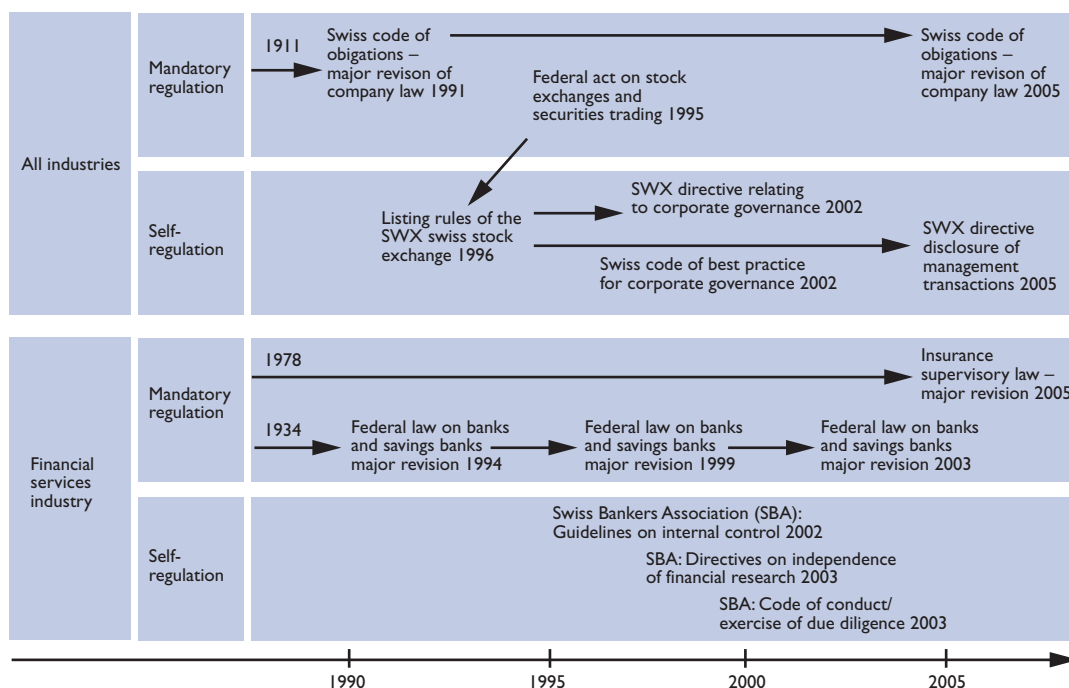
Developments in 2005

The traditional self-regulation in Switzerland has seen a significant pushback in 2005 with the passing of a revised company law and Insurance Supervisory Law (see Figure 1). The relatively high speed at which those new regulations passed through the legislation process was clearly influenced by developments in the US (Sarbanes-Oxley Act) and in the EU (8th Directive). Particularly in the area of auditor supervision, Switzerland had to create standards equivalent to the US and other countries in order to avoid foreign supervisory bodies checking Swiss auditors, e.g. when they audit a subsidiary of a company listed in the US.

The Swiss reforms enacted in 2005 also

demonstrate an increasing global convergence of some basic corporate governance standards such as external audit and auditor supervision, internal control, risk management as well as transparency requirements for companies. Most of the reforms concern all types of industries. The new regulations on audit and auditor supervision concern all types of companies, too, independent of their legal form. The Swiss legislator has introduced the principle of economic importance, i.e. all companies exceeding a certain size threshold² are considered economically important and, therefore, are subject to a regular audit requirement. This requirement goes beyond the current standard and will lead to an increase in audit effort and audit cost. On the other hand,

Figure 1: Development of selected Swiss regulations since 1990



Source: own chart

companies below the threshold will benefit from a certain relief. They will be subject to a so-called limited audit. Very small companies with less than 10 employees can even be fully exempt from any audit requirement³.

In future, with companies subject to a regular audit, the auditor will need to opine on the existence of a system of internal controls. This will require auditors to perform more thorough audit work within the area of internal controls. It will also put pressure on companies to formalise and enhance their systems of internal controls to avoid excess audit costs or, in the worst case, an adverse audit opinion.

New transparency requirements have been defined, especially in two rather sensitive areas: management pay and management transactions with shares of the own company. These new regulations concern companies that are publicly listed in Switzerland. Until 2005, there was a guideline issued by the SWX Swiss Stock Exchange that already required the disclosure of certain information of management pay, mostly in a summary format. The new regulation is based on company law and requires a more detailed disclosure of the individual pay to the members of the board of directors, the total pay to the members of the executive board and the highest pay to an individual member of the executive board. It also requires the individual disclosure of any loans granted to members of the board of directors or the executive board. As far as management transactions are concerned, individual transactions with shares⁴ of the own company need to be disclosed to the SWX Swiss Stock Exchange. If an individual transaction or a number of transactions within a month collectively exceed the threshold of SFr 100,000 the disclosure has to be made public.

The insurance industry in Switzerland had, until

2005, a relatively loose supervisory regime compared with the banking industry. The revised Insurance Supervisory Law represents a leap step and will strengthen the solvency regime by introducing an additional risk-based approach, the so-called Swiss Solvency Test⁵. It will also strengthen the internal and external supervision of insurance companies through a set of requirements regarding risk management, the designation of a responsible actuary within the company, the use of financial instruments, the application of certain accounting and reporting standards and external audit. Some of these requirements, e.g. the ones on risk management, are currently exceeding the ones Swiss banks have to fulfill, a traditionally highly regulated industry. However, with the implementation of the standards of Basel II for Swiss banks in near future, this gap is likely to disappear again.

The next reform wave for Swiss company law⁶

The reforms of the company law in 2005 have to be seen in the context of a wider corporate governance reform in Switzerland. Swiss company law is to be comprehensively modernised and brought into line with the needs of the economy. Besides the already enacted regulations a number of new regulations or revisions of existing regulations are in the pipeline (see Figure 2).

The initial draft bill for this next wave specifically strengthens the position of shareholders as the owners of the company. Their rights to information are set out in clearer terms, and in the case of private limited companies, they will be given the right to information on the remuneration packages paid to top management. Furthermore, the thresholds for the exercise of a variety of shareholders' rights – such as special audits and the

Figure 2: The current corporate governance reform project

Revisions enacted in 2005	Revisions in the pipeline
<ul style="list-style-type: none"> • Extended disclosure of management compensation • Extended regulations for limited liability companies • New auditor supervision (incl. regulations on internal control) 	<ul style="list-style-type: none"> • Lower thresholds for the exercise of certain shareholder rights • Revision of proxy voting rights • More flexible procedures for changes in share capital • Use of electronic tools for the annual general meeting • Revision of accounting and reporting legislation

Source: own chart

rights to convene meetings and have items included on the agenda – are to be lowered. Legal proceedings concerning the reimbursement of unjustified payments will be improved. In addition, the right of banks to exercise the voting rights attached to stock they hold in safekeeping, as well as the practice of shareholders being represented at annual general meetings by the company's own governing and executive bodies, will be abolished. In future, it will be possible to appoint only independent persons as proxies.

A second area of revision concerns the rules governing capital structures, which will take account of changing needs. The procedure for increasing and reducing share capital will be made more flexible. By adopting a 'capital band', the annual general meeting will be able to authorise the board of directors to increase or reduce share capital as it wishes within a given bandwidth. The present requirement for a certain minimum par value will also be relaxed, meaning that a company can lower the par value of its stock as close to zero as it wishes. The importance of bearer shares has declined steadily in recent years. They are therefore to be abolished, in line with the international trend. It will still be possible to issue bearer participation certificates, however. Furthermore, the present rules restricting participation capital to twice the level of share capital will cease to apply.

The regulations governing the holding of annual general meetings are another area that will be revised. In the future, companies will be able to use electronic tools when preparing for and holding their annual general meetings. The bill also contains rules on holding annual general meetings at several venues and abroad.

Finally, the initial draft also provides for a comprehensive revision of Switzerland's outdated accounting and reporting legislation. It will create standard rules for all forms of company, although requirements will differ depending on the economic significance of the company in question. The new rules will not impact on the amount of tax paid by the corporate sector and thus abide by the principle of authoritative law. Under certain circumstances, a company may have to produce an additional set of financial statements in accordance with recognised accounting and reporting requirements. This will significantly improve transparency and better protect those with minority holdings.

Conclusion

Switzerland is currently going through a significant corporate governance reform process, affecting both general company law and supervision law for regulated industries such as insurance. Many aspects are driven by the convergence of corporate governance standards as part of globalisation. However, the Swiss legislator is not just copying the foreign standards but rather applying the traditional 'Swiss finish'. After the conclusion of the next corporate governance reform as outlined above, it can be expected that the still existing gaps to standards in certain Anglo-Saxon countries will be reduced to a minimum. Swiss corporate governance should then be able to qualify for the Champions' League as well.

Notes:

- ¹ Markus T. Schweizer is partner of Ernst & Young Switzerland and Leader Corporate Governance Services.
- ² The threshold is as follows: Total assets of SFr10m, net sales of SFr20m and 50 employees – two of the three criteria exceeded in two consecutive years
- ³ The so-called 'opting-out' is possible for small companies that are not subject to a regular audit requirement and that have less than 10 employees if all shareholders agree
- ⁴ Or certain other financial instruments (derivatives of the company shares etc.) deemed relevant
- ⁵ Equivalent to the Solvency II requirements discussed within the EU
- ⁶ Based on: Federal Office of Justice, media release, December 5, 2005; see also at www.ejpd.admin.ch

Author:
Markus T. Schweizer, Partner
Leader Corporate Governance Services
Ernst & Young Ltd
Bleicherweg 21
8022 Zurich
Switzerland
Tel: +41 58 286 31 11
Fax: +41 58 286 30 04
Email: markus.schweizer@ch.ey.com
Website: www.ey.com/ch