

SWITZERLAND



Law and Practice

Contributed by:

Anna Neukom Chaney, Julien Boulter, Daniel Küpfer and Marco S. Meier
Binder Rechtsanwälte

Contents

1. Incentivisation p.3

- 1.1 Market Practice (General) p.3
- 1.2 Market Practice (Public v Private Companies) p.4
- 1.3 Future Developments p.4
- 1.4 Common Plans p.4

2. Share Plans: Legal and Tax Issues p.5

- 2.1 Prospectus or Filings p.5
- 2.2 Promoting the Plan p.5
- 2.3 Funding the Plan p.5
- 2.4 Grant Process p.6
- 2.5 Exchange Controls p.6
- 2.6 Employee Tax and Social Security: Share Options/Awards/RSUs p.6
- 2.7 Employee Tax and Social Security: Restricted Shares p.7
- 2.8 Employer Tax: Withholding, Social Security and Corporate Tax p.7
- 2.9 Tax-Favourable Plans p.7

3. Share and Cash Plans: General p.8

- 3.1 Malus/Claw-back p.8
- 3.2 Employment/Labour Laws p.9
- 3.3 Post-Vesting or Post-Employment Holding Periods p.9
- 3.4 Data Protection p.9
- 3.5 Translation p.10

4. Remuneration Regulation, Corporate Governance and Disclosure p.10

- 4.1 Governance and Disclosure p.10
- 4.2 Remuneration Regulation and Reporting p.11

Binder Rechtsanw  lte is a boutique business law firm with offices in Zurich and Baden. It provides tailored, comprehensive and timely legal advice to legal challenges its clients face in all areas of business law, including – eg, employment law, corporate law and corporate governance, M&A and data protection law as well as

litigation. The international expertise of its partners and associates, as well as its network of proven experts from research and academia and established co-operations with partner law firms around the globe, enable it to provide competent and efficient assistance in matters with an international nexus.

Authors



Anna Neukom Chaney is a Certified Specialist in SBA Employment Law with in-depth knowledge of the field. From assisting employers with their day-to-day HR concerns to

advising on workplace conflicts, internal investigations and dismissals as well as compensation and equity plans, contracts, employee handbooks, settlement agreements and cross-border transactions, she accompanies her clients in all aspects of an employment relationship. She has long-standing experience in representing clients in court. She follows a nuanced approach and well-thought-out strategies, provides hands-on, tailor-made advice and is personally invested in the success of her clients.



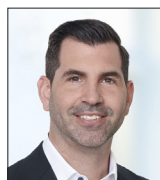
Daniel K  pfer has extensive know-how in a broad range of corporate and commercial matters. He advises companies on the conception, drafting and implementation of incentive and

share plans. He has a keen eye for strategy, is highly responsive, efficient and appreciated for his sound reasoning and fast thinking.



Julien Boulter is a very experienced employment lawyer and litigator who accompanies his clients through all stages of an employment relationship, namely from the beginning,

during and at the termination of an employment contract. He provides tactical and strategic advice on how to manage and solve employment issues, knows how to build a successful strategy and guides his clients through challenging court proceedings.



Marco S. Meier regularly advises clients on all employment-related data protection and technology matters. Marco's clients value his extensive experience and

in-depth knowledge, enabling him to tackle all kinds of data protection and technology-related questions. His hands-on approach, well-thought-out strategies and practical, objective and business-minded advice enable him to resolve data protection and technology issues quickly, efficiently and expertly.

Binder Rechtsanwälte KLG

Schützengasse 4
8001 Zürich
Switzerland

Tel: +41 584 044 000
Email: mail@binderlegal.ch
Web: www.binderlegal.ch

binder
rechtsanwälte

1. Incentivisation

1.1 Market Practice (General)

It is common practice, predominantly among listed and other large companies as well as start-ups, to allow selected employees to participate in cash and/or share incentive plans. Best practice guidelines for listed companies recommend using a compensation system that includes both fixed and variable parts and that, at least for the compensation of top executives, also offers share-based compensation packages. Companies often offer different variations of their incentive plan to certain groups of employees – eg, to members of lower and upper management.

While Swiss law does forbid listed companies from paying certain types of compensation (eg, golden parachutes), it does not set out a defined list of permitted variations for incentive plans, neither for listed nor for private companies. Due to this freedom, the incentive plans adopted in practice vary significantly. Nonetheless, they generally fall into one of the following categories or combine elements thereof:

- **Cash incentive plans:** Cash payments are made to employees if certain objectives in connection with the employee's and/or the company's performance are met. They are

typically structured as short-term incentives, contrary to the various types of share incentive plans.

- **Option plans:** Employees are granted the right to buy (actual or virtual, restricted or unrestricted) shares at a specific price (so-called exercise price, which is generally below market) in the future (at a set date only or, typically, within a certain period – the so-called exercise period).
- **Share plans:** Employees are directly granted (actual or virtual, restricted or unrestricted) shares for free or at specific, generally below market price.

Contrary to actual shares, virtual (or phantom) shares do not grant equity, but mirror the financial value or benefits of actual shares and, thereby, grant the financial benefits of owning shares in the form of a monetary claim against the employer. The main advantages for the employer are that the shareholder base is not greatly extended (this can have several disadvantages, at minimum a considerable administrative workload and a dilution of equity) and that employees do not receive non-financial shareholder rights (eg, right to information). The plan may include the full value of the mirrored share (ie, the value of the share and any appreciation) or only any appreciation (so-called appreciation rights). In

the end, phantom share plans can be described as cash incentive plans where the cash amount is linked to the value of the employer's shares.

While unrestricted shares are directly transferred into the ownership of the employee and may be disposed of freely, restricted shares are first merely promised or awarded (so-called grant) and must then be "earned" over time, typically over the course of several years (so-called vesting with a time-based cliff and/or vesting schedule). The vesting defers ownership because the employee does not receive ownership of the shares until the cliff and/or vesting period has expired and unless further (eg, ongoing employment) are fulfilled at the time. A cliff period refers to the period where either no vesting occurs at all (in this case it constitutes a waiting period) or the vesting occurs fully at a specific date (eg, after one year), as opposed to the gradual (eg, semi-annual or quarterly) vesting during the vesting period. A blocking or holding period refers to the period during which the employee may not dispose of the received shares.

Share options may also be subject to vesting. In this case, the options cannot be exercised until they are fully vested.

1.2 Market Practice (Public v Private Companies)

Listed companies are subject to specific legislation and financial market regulations (eg, to prevent insider trading) and are prohibited from certain types of compensation, but they may, in principle, offer the same types of cash or incentive plans as private companies. They are, in short, not prohibited from using any of the plans or mechanics described in **1.1 Market Practice (General)** but have to be more transparent about the compensation schemes offered to their employees.

Furthermore, in line with best practice guidelines, which recommend that compensation policies support sustainable development and long-term company growth, listed companies typically place a stronger emphasis on long-term incentivisation (eg, by including vesting and holding periods).

1.3 Future Developments

No significant legal, regulatory or tax developments that would impact cash or share incentive plans are anticipated within the next year.

1.4 Common Plans Cash Incentive Plans

The most common form of a cash incentive plan is an annual cash payment awarded when certain performance criteria are met. These typically include a combination of subjective assessments of the employee's individual behaviour and performance – factors that cannot be objectively measured – and objectively measurable criteria linked to the employee's or company's performance, such as individual sales quotas or EBITDA.

This hybrid model, which sits between a fully discretionary bonus and a variable salary, is particularly common because it strikes a balance between employer and employee interests. From the employee's perspective, it is not entirely discretionary, providing a degree of predictability, while from the employer's standpoint, it allows for significant flexibility in defining the plan's terms – something that would not be possible if all criteria were objectively measurable. The employer retains discretion, within the boundaries of good faith, in determining the amount of the cash payment. Additionally, the plan may impose further conditions – eg, that an awarded cash payment is only made if the employee is still employed at the time.

The prevalence of the different forms of cash incentive plans will also depend on the employer's resources, the sector and the roles of the targeted employees. For example, while discretionary annual cash bonuses are historically common in the financial sector, non-discretionary cash payments are predominant in sales, where a considerable amount of the salary may be dependent upon sales quotes being met. In comparison to share incentive plans, cash incentive plans are far easier and cheaper to set up and execute than share incentive plans, which pose a challenge from a legal and tax perspective. Consequently, cash incentive plans are generally more common with smaller companies, except for start-ups, which lack the funds for cash incentive plans and, therefore, prefer share incentive plans to allow employees to participate in the growth of the company's value.

Share Incentive Plans

The most common forms of share incentive plans specify that the employee will be granted shares or options that are subject to a vesting period of several years (usually between two and four) with a one-year cliff and gradual (semi-annual or quarterly) vesting thereafter. Further, the plan will typically specify that any unvested shares and options expire and that vested shares may be bought back by the employer if the employment relationship ends or is terminated before the vesting period is completed.

While plans with phantom options or shares became increasingly popular in the recent past, especially with start-ups, this trend seems to have been halted or even reversed. This may be due to the higher complexity of such plans or key employees demanding full participation, including a voice in the company's decision-making.

2. Share Plans: Legal and Tax Issues

2.1 Prospectus or Filings

In general, any company in Switzerland that offers securities (eg, shares or options) to the public must first publish a prospectus. An offer is deemed to be made to the public if it is offered to an unlimited number of addressees.

Given that employee share incentive plans are offered to employees only, they generally do not qualify as made to the public. There would, however, be uncertainties in this regard, especially in connection with large companies.

Luckily, there are various exceptions to the general rule, one being that no prospectus must be published when an employer or an affiliated company offers or allocates securities to current or former members of the board of directors or its employees. Consequently, no prospectus must be published due to an employee share or option plan.

No general filing obligations exist, but certain transfers of shares or options may trigger specific disclosure obligations (eg, transactions involving the management of listed companies).

2.2 Promoting the Plan

No restrictions apply to the promotion and communication of a share plan to employees.

2.3 Funding the Plan

As a party to the incentive plan, the employer is obligated to ensure that it can meet all its obligations under the plan, which include providing the necessary funding for the plan. Different actions are required (eg, capital increase and issuance of new shares, purchase of own shares on the mar-

ket or revision of articles of association) depending on the specific situation.

Employers may make payments to their parent company if their employees participate in the parent company's employee share plan, but such upstream payments must adhere to various restrictions and conditions of Swiss corporate and tax law.

2.4 Grant Process

A share incentive plan usually consists of the plan document as such, which is issued by the company's board of directors, and an award agreement concluded between the individual participating employee and the company. While the plan sets out the conditions and rules of the incentive scheme as such, the award agreement allocates a certain number of options or (phantom) shares to the employee. By signing the award agreement, the employee agrees to be bound by the underlying plan document.

If an employer sets up a share incentive plan, the participating employees will – sooner or later – become shareholders of the company. To facilitate the transfer of shares to employees, the company must prepare its share structure accordingly. This can be achieved by creating conditional share capital, which allows employees to exercise options, by issuing new shares through a capital increase, or by holding and offering treasury shares. A capital increase, irrespective of its nature (conditional or ordinary), requires a resolution of the shareholders' meeting of the company and must be registered with the competent commercial register.

When it comes to listed shares, the key elements of any share plan must be included in the annual report of the company, and any share or option or similar award to the board members or top

management must be annexed to the financial statement of the company. Further, the board of directors must prepare a compensation report (including information on the compensation system and the fixed and variable compensation for board members, top management and, if existent, the advisory board) to be submitted to and approved by the general meeting of the shareholders.

Based on special legislation, employers in the financial service industry must ensure the implementation of appropriate organisational measures to avoid conflicts of interest and customer discrimination.

2.5 Exchange Controls

No exchange control restrictions or reporting requirements that would arise from an employee sending/receiving any currency to/from a foreign jurisdiction or an employer sending any currency outside of Switzerland to provide funding for an incentive plan exist. Exceptions may apply in extraordinary circumstances (eg, with countries at war).

2.6 Employee Tax and Social Security: Share Options/Awards/RSUs

When shares are awarded to employees under "real" employee share plans (as opposed to phantom share plans), taxation is primarily determined by the time of purchase or allocation. The taxable amount is the difference between the fair market value of the shares and the price at which the employee acquires or purchases them. For non-listed companies, it is the employer's duty to provide the market price valuation. If no formula to value the fair market price is defined yet and the company has not yet achieved any significant profit, the net asset value of the shares or the so-called practitioners' method (average

of the net asset value and two times the capitalised earnings) will be used.

For blocked shares, a discount of 6% per annum on the market value is granted (for a maximum of up to ten blocking years).

If the share plan includes vesting conditions deferring the actual share award, income tax contributions are shifted to the time the vesting conditions are met.

Phantom shares are not taxable at the time the grant is made but only when the award is paid out.

If employees of unlisted companies are awarded share options, these are subject to income taxation at exercise. The amount subject to taxes is to be calculated based on the difference between the shares' market value and the exercise price. Unrestricted listed share options are taxed at the time of the grant. If income tax is charged at the time of grant, no income tax arises at vesting or exercise.

Social security contributions are to be made on the same amount, which is subject to income tax.

Capital gains realised from the sale of shares by an individual are usually not subject to tax or social security contributions (tax-free capital gain). Exceptions apply if, for example, the valuation formula determining the fair market value has changed from the acquisition to the sale of the shares and the typical five-year period between the acquisition and the sale has not been respected. Phantom shareholders are not eligible for tax-free capital gains (the entire payout received is taxable).

2.7 Employee Tax and Social Security: Restricted Shares

For the taxation of blocked or unblocked shares, the key factor is the difference between the fair market value of the shares and the price at which they were acquired or purchased by the employee. This difference is considered taxable income. For non-listed companies, it is the employer's duty to provide the market price valuation.

In general, employees are responsible for tax filings and must pay their income tax directly. An exception applies if the employee is taxed at source (to be withheld by the employer). This is mostly true for foreign nationals who do not hold a so-called C-permit (permanent residence permit).

2.8 Employer Tax: Withholding, Social Security and Corporate Tax

In general, employees are responsible for tax filings and must pay their income tax (on federal, cantonal and communal level) directly. An exception applies if the employee is taxed at source (to be withheld by the employer). This is mostly true for foreign nationals who do not hold a so-called C-permit (permanent residence permit).

Social security contributions are deducted by the employer directly from the employee's (monthly) payout and are to be forwarded to the competent cantonal social security authority.

2.9 Tax-Favourable Plans

Any plans including blocking periods for the sale of shares are favourable from a tax perspective. For blocked shares, a discount of 6% per annum on the market value is granted (for a maximum of up to ten blocking years).

3. Share and Cash Plans: General

3.1 Malus/Claw-back

The term “bonus” is not defined under Swiss law. It is used for various compensations such as incentives, share awards, shares of the operating result, gratuities or hybrid forms thereof, based on the contractual agreement between the parties.

The question of whether claw-backs or similar agreements are permissible (and thereby enforceable) under Swiss law depends on the qualification of the award (cash/share/bonus) that is subject to this clause. There is extensive case law on this topic which differentiates between the (fixed or variable) salary component and discretionary payments (so-called gratuities).

Whether an award is to be considered a discretionary payment or a salary component has to be analysed on a case-by-case basis, taking into account the following main criteria:

- Frequency/regularity of the bonus payment: If a bonus is paid to the employee on a regular basis – ie, several years in a row, it is to be assumed that – at least part of – the payment is to be considered salary. According to Swiss doctrine and case law, the payment of a bonus for three consecutive years without specifying the optional nature of the payment by means of a notification addressed to the employee concerned is sufficient to qualify as “regular”. In fact, an employee who routinely receives a bonus without any reservation being expressed (in the respective plan or, better, at payout) may legitimately rely on the principle that such bonuses will be paid in subsequent years.
- Accessoriness of the bonus: a bonus may only qualify as discretionary if it is supplementary to the salary – ie, the bonus must be of lower significance than the salary for the employee. This case law aims to prevent an employer from remunerating the employee primarily or solely through bonuses, which would create uncertainty regarding the level of their regular or variable income.
- The current case law on determining whether a bonus is “accessory” or not is complex and leaves many questions open. As a general rule, however, in case of lower salaries, a bonus payment that is more than half the amount of the fixed salary cannot qualify as “accessory”. When it comes to medium and high(er) salaries, the relation between bonus and fixed salary can be higher and has to be evaluated on a case-by-case basis. In any case, this requirement is dropped if the employee received payments (of any nature) equal to five times the annual median salary (currently approximately CHF400,000) or more in the respective year (not including the payment in dispute).
- Whether the amount of the bonus payment is at the discretion of the employer: A gratuity requires a certain degree of discretion. If the employer has no discretion over whether a bonus is paid – both in terms of its entitlement and amount – it will be classified as variable salary rather than a discretionary bonus. Consequently, any form of remuneration where the amount and due date are unconditionally predetermined must be regarded as salary. Such is the case with the thirteenth month’s salary and any other similar payment entirely determined by contract. When the amount is not set in advance, but depends on a pre-determined arithmetical rule, leaving the employer no discretion, it is also considered a salary component.

Case law states that claw-backs and other conditions are only permissible with regard to discretionary payments (gratuities). Therefore, if a payment qualifies as a salary component, a claw-back or any similar agreement is generally impermissible and unenforceable.

Also, claw-backs (restricting the employee post-employment) need to be pro-rated over time and – as a general rule – may not cover longer periods than three years. This means that the amount to pay back should be lowered by 1/12 after each month until a period of a maximum of three years in order to qualify as (fully) enforceable.

Furthermore, there is an ongoing debate as to whether a claw-back clause is extinguished if the employer terminates the employment relationship without just cause attributable to the employee, or if the employee terminates it for good cause due to the employer's actions (applying the respective clauses for post-contractual non-compete clauses by analogy). There is a considerable risk that courts would rule in favour of extinction in the aforementioned situations.

3.2 Employment/Labour Laws

Disputes on the enforceability of conditions contained in share or incentive plans (such as an ongoing employment relationship) are common when it comes to the termination of an employment relationship.

As stated in 3.1 **Malus/Claw-back**, if an award of share options or shares qualifies as salary, it is unconditionally due and must be paid pro rata if the employee leaves the company during the year. By contrast, gratuities may depend on conditions (in particular, non-terminated employ-

ment) and can be subject to time-based vesting conditions or forfeiture clauses.

In general, employers do not have to consult or agree with employees, work councils, trade unions or similar bodies before launching a share plan.

3.3 Post-Vesting or Post-Employment Holding Periods

In general, share incentive plans often include a buy-back clause if the employee leaves the company and/or a forfeiture clause so that, after notice has been given by either party, no further vesting occurs.

In line with best practice guidelines, post-vesting or post-holding periods are common in the share plans offered to employees of listed companies to ensure that they act in a way that serves the long-term growth of the company's value as well as to ensure compliance with insider trading regulations.

3.4 Data Protection

As a general rule, personal data of an employee may only be processed if it relates to the employee's suitability for the employment relationship or if it is necessary for the performance of the employment contract. However, further data processing may be justified, in particular, if it is in the overriding interest of the employer or with the express consent of the employee concerned. The collection and transfer of personal data relating to cash or share plans is part of the remuneration of the respective employee. Therefore, such data processing is necessary for the performance of the employment contract. This means that there is no legal requirement to obtain the employee's consent to the collection and transfer of personal data in relation to a cash

or share plan, as such data processing is already permitted by law.

However, the data processing principles of Swiss data protection law must still be observed. Among other things, data processing must be lawful, in good faith and proportionate – ie, in accordance with the purpose of the processing of personal data, which is clearly declared or obvious from the circumstances in which personal data is processed and in accordance with the other provisions of Swiss data protection law. A key provision in this respect is the requirement to inform employees about data processing relating to the collection and transfer of personal data when offering cash or share plans. Under Swiss data protection law, the employer, as data controller, must inform employees at least on the following:

- the identity and contact details of the controller;
- the purposes of the processing;
- the recipients or categories of recipients to whom personal data may be disclosed (eg, where a third-party tool is used or if a central HR department of a group company is in charge of administering cash or share plans); and
- if personal data is transferred abroad (the state or international organisation and, where applicable, the safeguards implemented for the transfer abroad – eg, where the aforementioned tool or another group company is outside of Switzerland).

The information is usually provided through a specific employee privacy statement.

Failure to comply with the above-outlined obligations in connection with cash and share plans

will subject the responsible person (not the company) to a personal fine of up to CHF250,000.

3.5 Translation

There is no requirement to translate cash or share incentive plan documents into one of Switzerland’s official languages. In an international setting, it is common for such documents to be drafted in English only.

It is, however, advisable to at least provide translations of summaries or the most important terms if there are employees participating that may not fully understand the English language to prevent such employees from later arguing that they could not understand certain terms and, therefore, were not able to agree to them, thus making them ineffective.

It should also be noted that exhibits to court submissions, or at least the sections therein relevant to the dispute at hand, must generally be translated into the official Swiss language of the proceeding – unless English is chosen as the language of the proceedings, which may be permitted based on cantonal regulations in some cases under the new Federal Civil Procedure Code. Therefore, the partial or full translation of cash or share incentive plan documents may become necessary in the case of a legal dispute.

4. Remuneration Regulation, Corporate Governance and Disclosure

4.1 Governance and Disclosure Governance Guidelines

The Swiss Code of Best Practice for Corporate Governance (SCBP), which is aimed at listed companies, contains a variety of recommendations regarding (i) the roles of the general meet-

ing of shareholders, the board of directors and the compensation committee; (ii) the principles of the compensation policy and compensation system; and (iii) the compensation report and transparency.

As a general rule, companies should structure their compensation policies to ensure that the board of directors, the executive board and employees are compensated for performing, and motivated to perform, in a way that supports the company's sustainable development and long-term value growth. The compensation system should be designed in such a way that it ensures the alignment of the compensation with the sustainable interests of the company on the basis of transparent and comprehensible criteria.

To that end, the SCBP recommends implementing and using a compensation system that includes both fixed and variable parts and that, at least for the compensation of top executives, also offers share-based compensation packages (with a clear stipulation of acquisition and holding periods). Further, to compensate both the achievement of short-term targets and the achievement of long-term targets, compensation packages should consist of immediately available components and of components that are deferred or blocked for several years. For non-executive board members, the compensation package should be limited to fixed components (payments and share allocations).

Disclosure Requirements

In addition to the annual report, listed companies must publish an annual compensation report. The compensation report must disclose all compensation that the company paid directly or indirectly to current members of the board of

directors, the executive board and (if applicable) the advisory board.

The compensation that must be disclosed includes salaries, bonuses, profit shares or any other forms of participation in the business results, and the allocation of equity securities, conversion and option rights.

Further, companies listed on the SIX Swiss Exchange must disclose certain information about compensation, shareholdings and loans, including the content and method of determining the compensation and the shareholding programme as well as the relevant rules in the articles of association.

4.2 Remuneration Regulation and Reporting

Say-On-Pay

Pursuant to the say-on-pay regulation in the Swiss Code of Obligations, in listed companies and in non-listed companies with a statutory opt-in, the general meeting of shareholders must vote annually and separately on the total amount for the remuneration of the board of directors, the executive board and, if applicable, the advisory board. If variable remuneration is voted on prospectively, the compensation report must be submitted to the general meeting of shareholders for an advisory vote.

(Gender) Equality

Based on the Federal Act on Gender Equality, employers must ensure the equal pay of women and men for equal work. Employers employing more than 100 employees must conduct an equal pay analysis, which has to be audited by an independent auditor.

Also, even though Swiss law does not foresee a general equality principle, one employee shall

not be discriminated against compared to others – ie, the choosing of employees allowed to participate in a share plan shall be transparent and non-discriminatory and any participants in the same share plan shall not be treated differently in equal situations.

Salary Certificate

All Swiss employers must provide their employees with a salary certificate, which includes all relevant employment income they have received in the applicable tax year. Share grants must also be reported in the salary certificate. In an annex to the salary certificate, the employer must include relevant information relating to the share compensation, such as plan name, grant and vesting date, and number of awards the employee received. This reporting obligation applies to all employees who have been in a Swiss employment relationship during the year, even if they have since left Switzerland.

Listed Companies

In listed companies, the articles of association must provide for the maximum term of the contracts that govern the remuneration of members of the board of directors, the executive board and, if applicable, the advisory board, as well as the principles on the duties and responsibilities of the remuneration committee.