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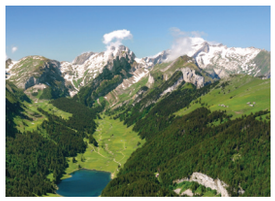

AWARDS AND COMPENSATION

Clawback on bonuses

Switzerland attempts to contain its liberal employment laws

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Executive compensation in financial institutions has been under scrutiny in Europe since 2010, in the aftermath of the global financial crisis. Switzerland is no exception, despite its liberal tradition.

In Switzerland, while the new legislation on shareholders' say on the salaries of directors of publicly traded companies, pioneered by Swiss voters in March 2013 (the so-called Minder initiative) made the headlines, a previous regulation enacted by the Swiss Financial Market Supervisory Authority (FINMA) went relatively unnoticed.

On 1 January 2010 a FINMA circular on the remuneration schemes of financial institutions came into effect, setting out 10 principles the FINMA considers minimum standards for remuneration schemes in the financial industry. The principles put the emphasis on risk/performance-related compensation, transparency and a long-term strategy. In particular, the FINMA stated that deferred compensation was appropriate if remuneration was related to the future evolution of success or risk.

Admittedly, only large banks and insurance providers (at least CHF2bn in equity capital) are required to implement the Remuneration Schemes Circular. All other banks, securities traders, insurance providers and entities authorised under the Collective Investment Schemes Act are to regard the principles of the Circular as guidelines when designing their remuneration schemes.

In the EU, despite UK objections to the provisions relating to the cap on bonuses of banks and investment firms under the Capital Requirements Directive (CRD IV), CRD IV came into effect on 1 January 2014. Since then, the Bank of England's Prudential Regulation Authority (PRA) has proposed requiring all regulated firms to amend employment contracts to provide employers with a right to claw back vested variable remuneration.

CRD IV is not applicable to Switzerland as it is not a member of the European Economic Area and a proposal such as that of the PRA would not be compatible with Swiss employment law.

A liberal tradition

From a Swiss perspective, clawback rules would be considered a significant departure from a system governed by liberal employment law and by the principle of autonomy of the parties. This principle means that – except for relatively few mandatory rules – employers and employees are free to agree on the terms governing their relationship.

Swiss statutory employment law has no specific provision dealing with employee incentive plans (stock options, share plans, bonus schemes and so on), let alone a clawback rule. The latter must be contractually agreed. Awards granted under an incentive plan are considered to be part of the employee's remuneration. They qualify either as a variable salary or so-called discretionary gratification.

Restrictions on the payment of salary are generally unenforceable. For example, incentive plans often provide that employees forfeit their rights and awards under certain circumstances, in the event of termination of employment. The enforceability of such provisions is generally admissible only if such awards qualify as gratifications under Swiss law.

The classification as gratification depends on criteria such as the agreement between the employer and the employee, the language used in contractual provisions in the employment agreement or the incentive plan, the percentage of total compensation (the ratio of salary versus gratification – recent case law suggests that gratification payments should not be higher than 50 per cent of total compensation), the frequency of grants (payment of gratification may become mandatory if paid for three consecutive years without any express reservation), and the position of the employee and the granting entity. Hence, it is of paramount importance to consider the overall compensation structure to assess whether or not a restriction on the bonus, such as a deferral, clawback or vesting condition, would be enforceable.

Furthermore, tax and social security contributions are generally charged when employees acquire a vested right in the bonus. Thus, irrespective of its qualification as gratification, clawback clauses on vested awards would trigger practical issues from a Swiss law perspective, as the employer would claim back benefits the employee already cashed in and paid taxes on.

Swiss banking and financial sectors welcome the prospect that neither the Swiss parliament nor the people (acting as lawmaker by the way of referendum) contemplate enacting rules similar to those advocated by the PRA. Thus, within the relatively flexible Swiss employment law and regulatory framework the agreement of private parties still prevails when it comes to the terms applicable to bonuses. Any state policy interfering with freedom of contract remains exceptional in the Swiss legal landscape. But so was the approval of the Minder initiative.

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