Lifting the veil

Prager Dreifuss's Andreas Moll and Matthias Bürge on why new transparency rules for Swiss companies could signal the end of the anonymous bearer share

Until the middle of last year, it was possible to hold shares in Swiss private companies on an anonymous basis. A Swiss company limited by shares, which had issued bearer shares, did not need to know who its shareholders were. In addition, with respect to unlisted Swiss companies, there were no rules requiring the disclosure of the beneficial owner for whom shares were held, irrespective of whether they had been issued as registered or bearer shares.

However, on July 1 2015, new rules aiming at increasing the transparency of ownership in Swiss companies came into force. From this date, the Swiss Federal Council put into effect the first part of the Federal Act of December 12 2014 on the implementation of the revised recommendations 2012 of the Financial Action Task Force (the FIA). The FIA amended several Swiss federal statutes, including the Swiss Code of Obligations (the CO). These amendments affect both shareholders of Swiss companies and the companies themselves.

Given the facts that approximately 50,000 Swiss companies limited by shares (almost a quarter of such Swiss companies) have issued bearer shares and the shareholders of the majority of all approximately 209,000 Swiss companies limited by shares and the quota-holders of most of the approximately 169,000 Swiss limited liability companies (LLCs) could be affected by the new obligation to disclose the beneficial owners, the amendments introduced by the FIA are highly significant.

The road to implementation

Switzerland has been a member state of the Financial Action Task Force (FATF) since 1990. The FATF is an international expert group that regularly issues recommendations and standards regarding the suppression of money laundering and financing terrorism. Switzerland has also joined the Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum), a multilateral organisation founded by the Organisation for Economic Co-operation and Development (the OECD) in 2000. Both the FATF and the Global Forum regularly review the standards of their member states.

The reviews of Swiss legislation by both the FATF in 2005 and the Global Forum in 2011 revealed that Swiss regulations no longer complied with the most up-to-date recommendations. The Swiss regulation was specifically criticised because it did not include a general mechanism allowing for the identification of the individual who ultimately controls Swiss companies. The Global Forum standards also require that a company is able to ascertain the identity of its shareholders. This was not the case with respect to the holders of bearer shares.

The new reporting obligations

Bearer shares

Pursuant to the new regulation (article 697i CO), any acquirer of bearer shares in a Swiss company limited by shares whose shares are not listed on a stock exchange must give notice of the acquisition to the company. The notice has to be provided within one month. This deadline will likely run from the completion of the acquisition rather than from the entering into the acquisition contract. The notice has to indicate the name and surname (or, in case of corporate entities, the business name), as well as the address of the acquirer.

In contrast to the regime for shares in listed companies, no thresholds are applicable to the new reporting obligations regarding unlisted companies. Accordingly, even the acquisition of a single bearer share in an unlisted company must be notified. The new notification regime for bearer shares of unlisted companies is stricter than the disclosure regime of listed companies.

The acquirer (new shareholder) must prove possession of the bearer share. The legislation does not set out particular requirements for this proof. It should be sufficient if the acquirer can show copies of the bearer shares and certificates. In case of doubt, the acquirer will have to show the originals. The acquirer has to identify themself. In the case of a natural person this shall be made by means of an official identity document such as the original or a copy of a passport, identity card or driver's license. Swiss legal entities have to provide an extract from the relevant Swiss register of commerce; foreign legal entities must provide a current certified extract from a foreign commercial register or an equivalent document.

The law does not state in what form the notification has to be made. For evidence purposes, it is advisable to notify the company in writing.

The shareholder must also notify the company of any subsequent changes of their name or address. While the regulation does not provide for a particular deadline, it seems advisable to make the notification within one month from the change in case the courts apply the above-mentioned one month deadline analogously in the future.

Although not explicitly stated in the new provisions, most legal scholars believe that the notification obligations are also triggered by the creation of a usufruct on bearer shares. However, the creation of a pledge over bearer shares is unlikely to give rise to a notification duty even if the pledgee is granted voting rights. The above notification duties also apply to acquirers of bearer participation certificates.

Shares in unlisted companies

The reporting obligation regarding the beneficial owner of the shares is set out in the new article 697j CO. It applies to both registered shares (shares issued to a named shareholder entered into a share register) and bearer shares.

The new provision states that any person who, acting alone or by agreement (ie in concert) with third parties, acquires shares in an unlisted company, and reaches or exceeds the threshold of 25% of the share capital or the voting rights, must notify the company of name, surname and address of the beneficial owner of the shares within one month from the acquisition. The beneficial owner is defined as the natural person for whom the acquirer is ultimately acting. From the provision's wording, it seems that legal entities cannot be reported as beneficial owners. Accordingly, there will be no need to report on intermediate holding companies.

In contrast to the regime with respect to the shares in listed companies under the Swiss Financial Market Infrastructure Act (FMIA), it is not the beneficial owner but the direct acquirer of the shares who is obliged to notify the company. Furthermore, the wording of the new provision suggests that it is irrelevant whether the beneficial owner holds and controls, respectively, 25% of the share capital or voting rights. It seems only relevant whether the respective direct acquirer reaches this threshold.

Pursuant to article 697j (2) CO, the shareholder must also notify the company of any subsequent change of name and address of the beneficial owner. However, the provision does not state whether a notice must be made if no shares are transferred but the beneficial owner changes (such as by transfer of an intermediate holding company). In view of the FIA's purpose of creating transparency

regarding beneficial ownership in unlisted companies, it is understood that a change of the beneficial owner also has to be reported. This may cause difficulties to shareholders as they may not always be aware of such changes.

The reporting obligations regarding the beneficial owner also apply to acquirers and holders of quotas in LLCs.

Exceptions to the rule

The reporting obligations under article 697i CO and 697j CO only apply if the shares of the company are not listed on a Swiss or foreign stock exchange. The rationale for this exception is the fact that the relevant stock exchange regulations regularly provide for disclosure obligations in the case of acquisition of substantial participations. According to some commentators, however, the exception should only apply if the foreign regulations set out similar disclosure rules as Switzerland.

The reporting obligations regarding bearer shares and the beneficial owner do not apply if the relevant shares are organised as intermediated securities in accordance with the Swiss Intermediated Securities Act. In this case, the company has to designate the custodian where the shares are held or recorded in the main register. The custodian must be in Switzerland.

To enable the acquirers and beneficial owners of bearer shares to remain anonymous vis-à-vis the company itself and its corporate bodies, article 697k CO provides for a further modification of both notification obligations. The general meeting of the company may resolve that notice relating to bearer shares is not given to the company but to a financial intermediary (for example, a bank, securities dealer or professional securities depositary) in terms of the Swiss Anti-Money Laundering Act. If the general meeting passes such a resolution, the board of directors is obliged to appoint the financial intermediary and to notify the shareholders of the appointee. The financial intermediary must provide the company at any time with information on the bearer shares for which the required notices have been given and possession proven (but not about the identity of the holders and beneficial owners).

Consequences of breach

If a shareholder fails to comply with the obligations to notify the acquisition of bearer shares or the identity of the beneficial owner in the case of reaching or exceeding 25% of the share capital or votes, the membership rights (the right to attend general meetings, voting and control rights) conferred by the relevant shares are suspended until the notification is made.

In addition, the shareholder may only exercise the financial rights conferred by the relevant shares upon compliance with the duty to give notice. Such financial rights include the rights to receive dividends and, in the case of liquidation of the company, to participate in the liquidation proceeds.

The harshest sanction is provided for in article 697m (3) CO: a shareholder failing to comply with the obligations to give notice within one month of acquiring the shares, forfeits the financial rights from the lapse of the deadline. If they give notice at a later date, they can only exercise the financial rights arising from the notification date. If the company resolved a dividend between the lapse of the one-month notice period and the delayed notification the shareholder's right to such dividend is forfeited. They will only be entitled to future dividends.

In view of the severity and the penal character of this sanction regime, legal commentators argue that the sanctions (namely the forfeiture of financial rights) should only be applied restrictively, taking into account the principles of proportionality and good faith. It is also argued that the severe sanctions would not be appropriate and should not be triggered if the shareholder only fails to notify a change in the (previously reported) name or address of the holder of bearer shares and the beneficial owners, respectively.

Failure to comply with the notification obligations will not prevent a valid transfer of ownership in the relevant shares. While the shareholder's rights may be suspended or even forfeited, such failure does not prevent the acquirer from becoming owner of the shares.

The described consequences of failing to comply with the notification obligations also apply to quotas in LLCs.

Duties of companies

Each company is obliged to keep a register of any bearer shareholders it has and the beneficial owners of shares (irrespective of whether it has issued bearer or registered shares).

The register must include the first name and surname or the business name and address of the bearer shareholders and the beneficial owners, respectively. With respect to bearer shares, it must also contain the nationality and date of birth of the bearer shareholders. The register is merely an administrative document; entries into the register have no constitutive effect regarding the shareholders' rights. The register is not publicly accessible.

The company must keep the documents on which notifications are based for ten years following the person's deletion from the register. If a financial intermediary has been appointed under article 697k CO, (s)he is responsible for keeping the register and the retention of documents. It must be possible for at least one board member or officer domiciled in Switzerland to access the register in Switzerland at any time. The register must

About the authors

Dr Andreas Moll
T: +41 44 254 55 55
E: andreas.moll@prager-dreifuss.com
W: www.prager-dreifuss.com

Andreas Moll is a partner in the corporate and M&A team of Prager Dreifuss. He specialises in mergers and acquisitions, corporate finance, takeovers and private equity, both on a domestic and international level. He also regularly acts as general corporate counsel, sometimes also as director, of Swiss entities. More recently, a significant part of his practice has involved debt restructurings and insolvency law.

Matthias Bürge
T: +41 44 254 55 55
E: matthias.buerge@prager-dreifuss.com
W: www.prager-dreifuss.com

Matthias Bürge is a partner in Prager Dreifuss's corporate and M&A team. His practice focuses on all types of domestic and international transactions (such as mergers, acquisitions, restructurings and spin-offs). He also advises with respect to acquisition financing, both on the financing bank's and on the borrower's side. Bürge has vast experience in the fields of corporate, contract and insolvency law. He also represents clients in court or before administrative authorities.

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ultimately also be accessible to the competent Swiss authorities, if needed (for example, if an electronic register is kept on a server abroad) by way of legal assistance.

The board of directors must ensure that no shareholders exercise their membership rights (particularly voting rights) and their financial rights (particularly dividend rights) while they are in breach of their notification obligations. Breach of this duty might expose the board members to personal liability (such as for unjustified payment of dividends). If shareholders participate in general meetings without being entitled, the respective resolutions will be challengeable.

The obligation to keep a list of beneficial owners and the duty to ensure that no quota-holders in breach of the notification obligations exercise their membership and financial rights apply to the LLCs and their managing officers *mutatis mutandis*.

Intertemporal regulations

The new provisions on the reporting obligations have applied to existing companies since July 1 2015. This is set out in article 1 (2) of the intertemporal provisions of the FIA (ITP).

Companies which existed on July 1 2015 and do not comply with the new provisions are granted a transition period of two years (until June 30 2017) to amend their articles of association and organisational regulations. After the lapse of this deadline, provisions of their articles or regulations that are not compliant with the new law become invalid.

The intertemporal regulations also provide for so-called retrospective reporting obligations applying only to holders of bearer shares who already held them on July 1 2015. Bearer shareholders had to make the notices within six months from the date on which the new rules came into force, ie by December 31 2015. Failure to do so resulted in the forfeiture of the financial rights pursuant to article 697m (3) CO. Accordingly, holders of bearer shares having missed the short deadline are well advised to notify as soon as possible in order to avoid a forfeiture of dividends resolved in the future.

There are no correspondent retrospective reporting obligations for holders of registered shares and quota-holders of LLCs.

Open issues

In 2005, an earlier revision project of the Swiss legislator had provided for the complete abolition of bearer shares to improve transparency of shareholdings. Following heavy criticism, this was discontinued and the legislator decided not to go that far in the FIA. However, although bearer shares will still be possible in the future, it is quite likely that the new legislation will be the beginning of the end for bearer shares in Switzerland.

The reporting duties regarding the identity of the bearer shareholders and the harsh sanctions in the event of their breach result in a substantial decline in the appeal of bearer shares. The ability to hold them on a completely anonymous basis was their main advantage as compared to registered shares. This has now disappeared (although anonymity may be kept vis-à-vis the company itself if registration of the notifications is delegated to a financial intermediary). In addition, the remaining advantage of bearer shares – their easier transferability – has been substantially diluted. While the (mere) ownership in bearer shares can still be transferred by simple transfer of the certificates, both the membership and financial rights can only be exercised upon complying with the reporting duties.

In practice, of even greater relevance than the new reporting obligations regarding bearer shares will be the new transparency rules regarding beneficial owners. These apply to both bearer and registered shares as well as quotas in LLCs – the majority of Swiss companies. They will be particularly significant for smaller (ie family-owned) companies, but are also relevant for group companies.

The transparency rules regarding beneficial owners leave much room for interpretation. Various issues arise and uncertainties remain, particularly with respect to indirect shareholdings. The legislation has thus been the subject of considerable criticism.

Several open questions have received significant attention:

- When a direct acquirer purchases shares for a company or a group of companies, it is unclear why the new legislation allocates the formal notification duty to the acquirer and not to the beneficial owners themselves (as is the case under the disclosure rules for listed companies). It might often be difficult for the acquirer to identify the ultimate beneficial owners, particularly if they are abroad;
- The event triggering the reporting duty is not the beneficial owner indirectly holding and controlling 25% of the share capital or voting rights. Rather, it is only relevant whether the direct acquirer reaches or exceeds the threshold. As a result, if the acquirer acts for a company or a group of companies, each shareholder of the company or group parent would have to be reported as beneficial owner, irrespective of whether such shareholder holds (alone or in concert with others) 25% of the company or the parent. Even a holder of one share of the company or parent would need to be reported. This is hardly practicable, and practice will show whether the legislation will be interpreted literally. Some legal commentators hold that it is a conceptual or editorial mistake that the reporting duty is not dependant on the participation controlled by the beneficial owner. They argue that, to trigger the reporting duty, the beneficial owners need to indirectly control the direct shareholding of 25%;
- The new reporting obligations do not apply to the acquisition of shares in listed companies. However, according to the wording of the new regulations, they would apply if a listed company acquired 25% or more of another company. All the beneficial owners of the acquired shares – the shareholders of the listed company – would thus need to be reported. This is probably not only factually impossible but would also be awkward as the reporting obligations regarding the subsidiary would go much further than, and would ultimately be in conflict with, the disclosure duties relating to the owners of the listed parent. Therefore, legal commentators argue that the exceptions from the duty to report the beneficial owners do not only apply to listed companies but also to their subsidiaries;
- Commentators discuss the question who needs to be reported as beneficial owner if a private equity fund or another collective investment scheme acquires 25% or more of a company. Potentially, it could be each investor in the fund or rather the members of the investment committee of the fund manager. There may not be any reporting duty at all;
- It is similarly unclear what 'acting by agreement with third parties' (acting in concert) means. Commentators question whether acquirers should always act in concert if they are bound by a shareholders' agreement. We believe that this should not be automatically assumed but needs to be analysed based on the particular provisions of the shareholders' agreement. Questions remain whether, in the case of shares held by various family members such as a community of heirs, the family members are to be considered as acting in concert.

It will be interesting to see how these open issues will be dealt with in practice and how the Swiss courts will formalise the new regulations. Meanwhile, investors and members of the boards of affected companies will often want to obtain legal advice under the circumstances of a particular case.