CORPORATE FINANCE/M&A - SWITZERLAND

Reporting of beneficial ownership in private equity transactions

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Background

Swiss law rules that the ultimate beneficial owners of a Swiss corporation must be disclosed to the company. The legal framework was enacted in 2015 and implemented recommendations of the Financial Action Task Force. It gave rise to controversial discussions. A major concern was that in certain situations, it was unclear from the perspective of both the shareholders and the company who should be reported by the shareholders and recorded in the register of beneficial owners to be maintained by the company as the beneficial owner, particularly in the event of multi-layered acquisition structures in private equity transactions.

To remedy these practical deficiencies and provide for greater legal security, Parliament enacted a revision of the disclosure provisions. The new legal framework streamlines the notification obligations. Simultaneously, it provides for stricter penalties for non-compliance. The revised law also to a large extent prohibits the use of bearer shares for Swiss corporations.

This article outlines the notification obligations for Swiss corporations with registered shares in the context of private equity transactions. The same rules generally apply for Swiss limited liability companies. In the limited cases where bearer shares are still allowed to be used, additional disclosure obligations apply.

Simplified disclosure obligations and exemptions

According to Article 697j of the Code of Obligations, anyone who (alone or together with third parties) acquires 25% or more of the shares or voting rights in a Swiss corporation must notify the company of the name(s) and address(es) of the beneficial owner(s) for which they ultimately act. The beneficial owner is always a natural person. If the beneficial owner is unknown to the acquirer, it must enquire in order to determine such beneficial owner. However, certain reliefs apply in the event of listed companies or if the target company has issued registered securities.

In certain cases, the beneficial owners cannot be determined or there may not be any beneficial owner in the sense of Article 697j of the Code of Obligations at all. If there is no beneficial owner, this fact must be notified to the target company. However, if (despite respective research work) the beneficial owners cannot be determined or if it is unclear whether there are beneficial owners in the sense of Article 697j of the Code of Obligations, it is nonetheless recommendable to report the top executive officer of the acquiring company, in order to mitigate the risk of a lack of notification.

Multilayer acquisition structures

Legal requirements

The identification of the beneficial owner can be complex if neither the target company nor the acquirer are listed and the target's shares are not issued as intermediated securities. In this situation, the acquiring company must disclose the natural persons who control the acquiring company in the sense of Article 963(2) of the Code of Obligations. Someone exercises such control if they:

- hold, directly or indirectly, the majority of the votes in the supreme corporate body (ie, the shareholders' meeting in the event of a corporation);
- have, directly or indirectly, the right to nominate or dismiss the majority of the members of the supreme

operative or supervisory body (ie, in the event of a corporation, the board); or
- can, based on the articles, a contract or similar means, exercise a controlling influence.

Usual set-up of a private equity acquirer and practical implications
In a usual private equity set-up, several limited partners invest in a fund, which is run by a general partner. An investment manager or investment adviser advises the general partner and often carries out most of the day-to-day work, while the general partner focuses on strategic decisions. The investment adviser is regularly controlled by the individuals launching the private equity fund and other key employees of the team responsible for the selection and management of the investments in the portfolio companies. Thus, while the investment manager or the general partner are in charge of the investment decisions and will usually exercise certain control rights or even make day-to-day decisions in the individual portfolio companies, the investment manager and the general partner's economical stake in the performance of the portfolio company is in most cases limited to a management fee and a performance fee, the so-called 'carried interest', a share of profits that the general partners of private equity (or hedge) funds receive as compensation regardless of whether they or their shareholders contributed any initial funds. However, carried interest is often paid only if the private equity fund's returns meet a certain threshold. Conversely, the investors' role is usually limited to the contribution of capital and participation in the performance of the portfolio companies, while their influence in the general partner and thus in the management of the fund and the individual portfolio companies is limited, unless they co-invest alongside the fund in one or more of the portfolio companies and thus separately – outside the fund structure – (exceptionally) obtain certain control rights in such particular portfolio companies.

The private equity fund in turn holds the acquisition company either directly or via one or more holding companies – or in more complex structures, several limited partnership structures run by one or more general partners hold the target company through several layers of holding companies.(1)

Consequently, in a typical private equity structure, the economic ownership rights on the one hand and the management and control rights over the portfolio companies on the other hand usually fall apart, making it difficult in practice to identify one or more typical beneficial owners within the meaning of Article 697j of the Code of Obligations. Although the law formally refers to the management and control rights (see above), most of the time these are congruent with the ownership rights.

In such set-up, the individuals controlling the general partner or its ultimate shareholder should generally be disclosed as beneficial owners. These persons (indirectly) exercise a controlling influence on the acquisition company (ie, the company obligated to submit the beneficial owner notification) and determine its board members, policies and key business decisions. If no particular shareholders have, alone or together, control over the general partner (or over the various general partners, in case of complex structures), the directors or officers usually of the general partner, or exceptionally of the investment manager, taking the determining decisions at the general partner level should be disclosed as (deemed) beneficial owners.

Depending on the circumstances, other persons may (also) have to be disclosed as beneficial owners. For instance, this may be the case if certain persons control a limited partner (or its ultimate shareholder) which takes an active part in running the fund and thus, indirectly, a controlling influence on the acquisition company. The same could apply for persons controlling the investment manager (or its ultimate shareholder). However, this is an unusual situation in a private equity set-up. Nonetheless, the individual situation must be assessed in each acquisition in order to determine who will be disclosed as beneficial owners.

Beneficial owner notification and register

The notification must be made within 30 days after the acquisition of the shares. Non-compliance with this provision has severe consequences (see below).

Based on the notifications that it receives, the company must keep a register of its beneficial owners. The register must include the names and the addresses of the beneficial owners. It can be kept separately or included in the share register (eg, by adding a column indicating the beneficial owners in addition to the formal shareholdings). The register, the notifications and their annexes must be accessible at any time in Switzerland.

Penalties

Non-compliance with the revised provisions regarding the disclosure of beneficial owners is subject to potentially severe penalties. The most important penalties are the following:

- As long as a due beneficial owner notification is not made, the shareholder cannot validly exercise its membership rights (particularly its voting rights in the shareholders' meeting).
- If the beneficial owner notification is not made within 30 days, the financial rights (particularly the dividend rights) pertaining to the shares which arise before the notification is eventually made are

forfeited.

- If the company does not properly keep the register about the beneficial owners notified to it, a shareholder, a creditor or the commercial registry office can require the competent court to "take the necessary measures". In particular, the court can set a deadline to the company to comply with its obligations or (as a means of last resort) order the opening of bankruptcy proceedings.
- Those who intentionally do not proceed to the beneficial owner notification may be fined according to Article 327 of the Penal Code. Thus, private equity buyers must consider that non-compliance with the disclosure obligations may expose their representatives to penal prosecution.

Beside formal penalties, non-compliance with the disclosure obligations can also lead to a series of practical issues. For instance, if a board member (or an entire board) is elected by a shareholder that is unentitled to vote, the question will arise of whether contracts signed by such person (or approved by such board) are valid. This underlines the need to carefully comply with the notification obligations.

For further information on this topic please contact Alexander Vogel or Christian Rebell at Meyerlustenberger Lachenal by telephone (+41 44 396 91 91) or email (alexander.vogel@mll-legal.com or christian.rebell@mll-legal.com). The Meyerlustenberger Lachenal website can be accessed at www.mll-legal.com.

Endnotes

(1) Further information is available here.

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