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Yvette Märki

## Rethinking Reserves in the Swiss Code of Obligations

with special regard to Reserves based on the Articles  
of Association



# **Rethinking Reserves in the Swiss Code of Obligations**

**with special regard to Reserves  
based on the Articles of Association**

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vorgelegt von

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*To Yvette & Humberto*



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Yvette Maerki





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# Index of Abbreviations

AB	Official Bulletin, Amtliches Bulletin
AJP	Journal, Aktuelle Juristische Praxis
ARB	Accounting Rules for Banks
Art.	Article
AS	Official collection of formal norms, Amtliche Sammlung
ASA	Journal, Archiv für Schweizerisches Abgaberecht
BankG	Banking Act, Bundesgesetz vom 8. November 1934 über die Banken und Sparkassen (Bankengesetz, SR 952)
BankV	Banking Ordinance, Verordnung über die Banken und Sparkassen vom 30. April 2014 (SR 952.02)
Basel II	Second of the Basel Accords issued by the Basel Committee on Banking Supervision
Basel III	Third of the Basel Accords issued by the Basel Committee on Banking Supervision
BGE	Published verdict of the Swiss Federal Tribunal, veröffentlichter Bundesgerichtsentscheid
BGer	Unpublished verdict of the Swiss Federal Tribunal, unveröffentlichter Bundesgerichtsentscheid
BK	Commentary, Berner Kommentar
Botschaft	Botschaft des Bundesrates (The dispatches that Federal Council submits to the Federal Assembly provide an explanation of the bills it drafts, i.e. new draft acts, draft amendments to the law, draft federal decrees and draft state treaties, which are submitted to the Federal Assembly for approval.)
BSK	Commentary, Basler Kommentar
CC	Civil Code or Schweizerisches Zivilgesetzbuch vom 10. Dezember 1907 (SR 210)
Cf.	confer, compare
CHF	Schweizer Franken, Swiss Francs
CHK	Commentary, Handkommentar zu Schweizer Privatrecht
Cl.	Clause

CO	Code of Obligations, Bundesgesetz betreffend die Ergänzung des Schweizerischen Zivilgesetzbuches (Fünfter Teil: Obligationenrecht) vom 30. März 1911 (SR 220)
CR	Commentary, Commentaire Romand
dCO	draftCO
E-	Entwurf, draft
ed	Edition or editor
eds	Editors
EF	Journal, Expert Focus
EFV	Federal Finance Administration, Eidgenössische Finanzverwaltung
e.g.	exempli gratia, for example
ERV	Ordinance concerning Capital Adequacy and Risk Diversification for Banks and Securities Traders, Verordnung über die Eigenmittel und Risikoverteilung für Banken und Effekthändler, (SR 952.03)
et al.	et alii, and others (m.)
et seq.	et sequens, the following (f.)
et seqq	et sequentes, the following ones (ff)
FASB	Financial Accounting Standards Board
FER	Financial Reporting Standards, Fachempfehlungen zur Rechnungslegung
FIDLEG	Financial Services Act, Finanzdienstleistungsgesetz
FinfraG	Law on Financial Market Infrastructure, Bundesgesetz über die Finanzmarktinfrastrukturen und das Marktverhalten im Effekten- und Derivatehandel of 19th June 2015 (SR 958.1)
FINIG	Law on Financial Institutions, Finanzinstitutsgesetz
FINMA	Swiss Financial Market Supervisory Authority, Eidgenössische Finanzmarktaufsicht
FS	Festschrift
GAAP	Generally Accepted Accounting Principles
GesKR	Journal, Journal, Schweizerische Zeitschrift für Gesellschafts- und Kapitalmarktrecht sowie Umstrukturierungen
HWP	Swiss Handbook of Auditing, Schweizer Handbuch der Wirtschaftsprüfung
i.c.w.	in conjunction with
IAS	International Accounting Standards



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IASB	International Accounting Standards Board
Ibid.	Ibidem (in the same place)
i.e.	id est, that is
IFRS	International Financial Reporting Standards
KAG	Swiss Federal Collective Investment Act, Bundesgesetz vom 23. Juni 2006 über die kollektiven Kapitalanlagen
KR	Listing rules Kotierungsreglement (of SIX Swiss Exchange)
LiqV	Directive on the Liquidation of Banks, Verordnung über die Liquidität der Banken vom 30. November 2012 (SR 952.06)
Lit.	Litera (letter)
LLC	Limited Liability Company
N	National Assembly, Nationalrat
No.	numero, numerus, number
p.	pagina, (page)
pp	pages
par.	Paragraph
RAG	Federal audit supervisory authority, Revisionsaufsichtsbehörde
REPRAX	Zeitschrift zur Rechtsetzung und Praxis in Gesellschafts- und Handelsregisterrecht
ReIV-FINMA	Rechnungslegungsverordnung-FINMA, Ordinance ARB
revCO	Revised Code of Obligations
S	Council of States, Ständerat
SEC	United States Securities and Exchange Commission
SFT	Swiss Federal Tribunal (Federal Supreme Court of Switzerland)
SIC	Interpretations Committee
SIX	SIX Swiss Exchange
SJZ	Journal, Schweizerische Juristen-Zeitung
SMEs	Small and medium-sized Entities
SR	Systematical Collection of Law, Systematische Gesetzessammlung
ST	Journal, Schweizer Treuhänder
StE	Tax Verdict, Steuerentscheid
Swiss GAAP	Swiss Generally Accepted Accounting Principles
SWX	Stock Exchange Zurich

SZW	Journal, Schweizerische Zeitschrift für Wirtschafts- und Finanzmarktrecht
UK	Kingdom
VASR	Recognised Financial Reporting Directive, Verordnung über die anerkannten Standards zur Rechnungslegung vom 21. November (SR 22.432)
VE	Pre-draft, Vorentwurf
VegüV	Ordinance against Excessive Remuneration in Listed Companies, Verordnung gegen übermässige Vergütungen bei börsenkotierten Aktiengesellschaften vom 20. November 2013 (SR 221.331)
ZBJV	Journal, Zeitschrift des Bernischen Juristenvereins
ZGR	Zeitschrift für Unternehmens- und Gesellschaftsrecht
ZK	Commentary, Zürcher Kommentar

# Glossary

<b>English</b>	<b>German</b>	<b>French</b>	<b>Italian</b>
Accounting Reserves	Rechnungslegungs-Reserven	Réserves de la présentation de compte	Riserve de la Presentazione dei conti
Acquisition or manufacturing costs	Anschaffungs- oder Herstellungskosten	Le coût d'acquisition ou le coût de revient	Il costo di acquisto o di produzione
Additional capital contributions	Nachschusspflicht	Les versements supplémentaires	I versamenti supplementari
Administration (or Directors)	Verwaltung	L'administration	L'amministrazione
Agio (Latin for additional paid-in capital)	Aufgeld (Agio)	Les frais d'émission	Le spese d'emissione
Annual Accounts	Jahresrechnung	Les comptes annuels	Il conto annuale
Annual Report	Geschäftsbericht	Le rapport de gestion	La relazione sulla gestione
Articles of Association	Statuten	Les statuts	Lo statuto
Assets	Aktive	Les actifs	Gli attivi
Authoritative principle	Massgeblichkeitsprinzip	Le principe de détermination	Il principio di dipendenza
Balance Sheet	Bilanz	Le bilan	Il bilancio
Basic Capital	Grundkapital	Le capital social	Il capitale sociale
Board of Directors	Verwaltungsrat	Le conseil d'administration	Gli amministratori
Buffer Capital	Kapitalpuffer	Le volant de fonds propres	Il cuscinetto di capitale

<b>English</b>	<b>German</b>	<b>French</b>	<b>Italian</b>
Capital Increase (ordinary, authorized or contingent)	Kapitalerhöhung (ordentliche, genehmigte oder bedingte)	Augmentation du capital-actions (ordinaire, autorisée o conditionnelle)	L' aumento del capitale azionario (ordinario, autorizzato o Condizionale)
Capital Reserves	Kapitalreserve	La réserve légale issue du capital	La riserva legale da capitale
Challenging (resolutions)	Anfechtung	Droit d'attaquer	Il diritto di contestare
Company member	Gesellschafter	Un associé	Il socio
Competence /duty	Aufgaben /Kompetenzen	Attributions	L' attribuzione
Member of a cooperative	Genossenschafter	Un membre de la coopérative	Un membro della società cooperativa
Consolidated accounts	Konzernrechnung	Les comptes annuels consolidés	Il conto di gruppo
Debt capital /borrowed capital	Fremdkapital	Les capitaux étrangers	Il capitale di terzi
Dispatch (Federal Council Dispatch)	Botschaft des Bundesrates	Message du Conseil Fédéral	Messaggio del consiglio federale
Equity or shareholder's equity	Eigenkapital	Les capitaux propres	Il capitale proprio
Expenditure	Aufwände	Les charges	I Costi
Financial statements of the individual entity	Einzelabschluss	Les comptes annuels	La chiusura contabile singola
Additional capital contributions	Nachschusspflicht	Les versements supplémentaires	I versamenti supplementari

<b>English</b>	<b>German</b>	<b>French</b>	<b>Italian</b>
General Assembly	Generalversammlung	L'assemblée générale	L'assemblea generale
General Meeting	Gesellschafterversammlung	Assemblée des associés	La assemblea dei soci
Hidden Reserves	stille Reserven	Les réserves latentes	Le riserve latenti
Income	Erträge	Les produits	I ricavi
Legal Reserves	Gesetzliche Reserven	Les réserves légales	Le riserve legale
Liabilities	Passiven	Les passifs	I passivi
Management	Die Geschäftsführung	La gestion	La gestione
Management report	Lagebericht	Le Rapport annuel	La Relazione annuale
Member of a cooperative	Genossenschafter	Un membre de la coopérative	Un membro della società cooperativa
Negative item	Minusposten	(...) en diminution des capitaux propres	Il elemento negativa
Notes to the accounts	Anhang	L'annexe	L'allegato
Nullity	Nichtigkeit	La nullité	La nullità
Own shares or own contributions	Eigene Aktien oder Kapitalanteile	Propre actions o propres parts du capital	Azione proprie o le proprie quote del capitale
Profit and Loss Account	Erfolgsrechnung	Le compte de résultat	Il conto economico
Provisions	Rückstellungen	Les provisions	Gli accantonamenti
Retained earnings reserve (statutory or voluntary)	Gewinnreserven (gesetzliche oder freiwillige)	La réserve légale ou facultative issue du bénéfice	La riserva legale o facoltative da utili
Revaluation reserve	Aufwertungsreserve	La réserve de réévaluation	La riserva di rivalutazione

## Glossary

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<b>English</b>	<b>German</b>	<b>French</b>	<b>Italian</b>
Resolution	Beschluss	Une décision	La deliberazione
Shareholder	Aktionär	L'actionnaire	L'azionista
Shareholder's subscription right	Bezugsrecht	Le droit de souscription préférentiel	Il diritto d'opzione

Adapted by Yvette Maerki, see <https://www.admin.ch/opc/de/classified-compilation/19110009/index.html> (last accessed: 15/01/2021)

# Introduction

The aim of this dissertation is to rethink the possibilities offered by the Swiss Code of Obligations for creating and releasing reserves. In particular, this work examines voluntary retained earnings reserves, as defined in the company limited by shares law, and compares them to a special reserve in the banking sector, the reserve for general banking risks. I propose a more extensive use of voluntary retained earnings reserves based on the articles of association through the introduction of an option to make use of this already existing category of risk reserves in non-banking companies that corresponds to the use of reserves for general banking risks in the banking sector. For this purpose, I will analyse whether the competence to create and dissolve reserves, which falls under the authority of the general assembly as per Art. 672 CO (Art. 673 revCO), may be delegated to the board of directors.

1

My investigation will focus on small or family companies which are not listed, and therefore are exempt from complying with the IFRS and only subject to the Code of Obligations. I will, as far as possible, restrict my analysis to the CO rather than the International Standards. In order to compare all types of open reserves, it will be necessary to show the similarities and divergences between the banking sector and the non-banking sector.

2

This work comprises three parts. Part I defines reserves and describes their legal nature and characteristics as well as what distinguishes them from similar instruments. Here, I will emphasise some critical aspects. Furthermore, an overview of all the types of open and hidden reserves defined in the CO and the reserves available to banks will be provided. Thereafter, I analyse whether these different categories of reserves comply with the financial accounting and banking sector regulations. Part II, which focuses on the distribution of competences between the executive body and the general meeting, is divided into two separate sections on the non-banking sector, otherwise known as the real economy, and the banking sector. The key question to answer in relation to each form of company is whether it is permitted and appropriate for the general assembly to delegate the competence to create reserves based on the articles of association to the executive body. Such a delegation seeks to achieve through a delegation clause in the articles of association what is already an option in the banking sector: namely, a form of special reserves that may be created as open reserves by the board of directors or, more generally, the executive body. Thereafter, the corresponding question arises as to whether competences that have been delegated in this manner may be dele-

3

gated once again to a manager. Finally, a closer look is given to the banking sector, in which reserves for general banking risks are allowed to be created by the board of directors. Consideration is given to how banking companies limited by shares and banking cooperatives differ from each other, given that the executive body in both may create reserves for general banking risks as an additional form of risk reserve.

- 4 Part III analyses the different effects of reserves. First, the impact of reserves in crisis situations will be investigated. Thereafter, the effects of a delegation of the competence to create and dissolve reserves to the board of directors will be questioned and compared to similar concepts like the newly introduced capital band and the delegation of the competence to restrict or revoke the shareholder's subscription right to the board.
- 5 A glossary containing the basic terms in the official Swiss languages (German, French and Italian) has been created, as English is not an official language in Switzerland. In this work I used the official translation; as translation always brings some incongruities, some unresolved issues remain. For the revised Code of Obligations, the abbreviation revCO is used.



# I. Reserves



## Preliminary Remarks to Part I

Part I will be dedicated to defining and explaining the notion of reserves, how they function, and their protective impact on equity. Thereafter, similar concepts, especially that of provisions, will be described with the aim of showing how they differ from reserves while possessing a very similar function. Furthermore, the executive body's competence to create and dissolve provisions will be discussed. 6

In a next step, open reserves will be differentiated from hidden reserves, with an emphasis here again placed on the authority of the executive body to create and dissolve hidden reserves. The three types of hidden reserves that exist in practice – which are recognised in the doctrine as forced hidden reserves, arbitrary hidden reserves and discretionary reserves – will also be described. 7

Thereafter, an overview of all types of open reserves will be provided, including statutory reserves and voluntarily reserves – at the discretion of the general assembly, which are both classified according to their basis in law. The aim here will be to analyse the rules for the creation and dissolution of the reserves regulated by the CO while always bearing in mind the question of which body has the competence to create and dissolve these types of reserves. The company limited by shares is used as a model here because most of the rules that apply to this form of company are also applicable to the other company types by referral. Finally, a special type of reserve – reserves for general banking risks – that only exists in the banking sector is described and compared to open reserves, hidden reserves and provisions. 8

Reserves are regulated by the principles of the CO. This work will analyse whether the various types of reserves comply with the CO's regulations. A further question will be whether there is any contradiction between the aim of being prudent and that of ensuring transparency in order to provide reliable financial reports to third parties. Thereafter, the highly regulated financial sector will be discussed in the context of the regulations for reserves for general banking risks, which will be described and compared to the reserves stipulated in the CO. 9



# 1. The Notion of Reserves

## 1.1. Open Reserves

### 1.1.1. Legal Nature

The CO mentions the term “reserves” in the context of the minimum structuring requirements of a balance sheet.<sup>1</sup> Debt capital and equity must be entered into the balance sheet as liabilities.<sup>2</sup> In this sense, the current and long-term capital as well as the equity must be shown among the liabilities. Equity is subdivided into (a) basic, shareholder, or foundation capital;<sup>3</sup> (b) legal capital reserves; (c) legal retained earnings; (d) voluntary retained earnings or, when negative, accumulated losses; (e) own capital shares when negative.<sup>4</sup> Reserves can thus be classified as equity according to this subdivision of equity.<sup>5</sup> The term “reserves” can easily be misunderstood as reserves in the sense of assets, i.e. real goods, such as commodities, which are shown among the assets.<sup>6</sup> Furthermore, reserves are not saved capital, which may be withdrawn whenever needed.<sup>7</sup>

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The equity included among the reserves represents the difference between a company’s financial liabilities, on the right-hand side of its balance sheet, and the company’s assets on the left-hand side.<sup>8</sup> Alternatively, equity included among the reserves may be calculated as the difference between all liabilities

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<sup>1</sup> Art. 959a par. 2 no. 3 literae b-d CO.

<sup>2</sup> Art. 959 par. 4 CO.

<sup>3</sup> Shareholder equity must be shown and structured in the required legal form as stipulated in Art. 959 par. 7 CO: share capital and participation capital for corporations, company capital for limited liability companies, cooperative capital for cooperatives, or association capital for associations; cf. BSK II-NEUHAUS/GERBER, Art. 959a OR, par. 73.

<sup>4</sup> Art. 959a par. 2 no. 3 literae a-e CO.

<sup>5</sup> Cf. VON DER CRONE, § 13, par. 512.

<sup>6</sup> REICH, Die Realisation, p. 3.

<sup>7</sup> Cf. HOMBURGER, Die Reserven, pp 39 and 51.

<sup>8</sup> Cf. Botschaft 2008, p. 1706; MEYER, CONRAD, Accounting, p. 24; MEYER, CONRAD, Finanzielles Rechnungswesen, p. 40.

and the debt capital.<sup>9</sup> Hence, equity is a residual value<sup>10</sup> that depends on the value of the reserves. The overall value of the equity – and thus, of the reserves – is crucial, especially in relation to shareholders' rights.<sup>11</sup>

- 12 Furthermore, equity forms the basis of liability; in case of liquidation or insolvency, the claims of the lenders and creditors are satisfied first, while those of the shareholders are satisfied last.<sup>12</sup> According to the financial definition, equity is the amount that is invested by a company's shareholders for an unlimited period of time as well as that which is gained through a company's business activities.<sup>13</sup>

### 1.1.2. Function

- 13 As described above, reserves are classified as equity. Before the function of reserves is explained, it is important to show how reserves operate, especially in order to clarify the relevant terminology: In the doctrine, one function which is attributed to equity is to fulfil the role of a risk reserve for a company,<sup>14</sup> as such, a company's equity is correlated to its risk capacity.<sup>15</sup> Thus, when describing the function of reserves, it is wrong to think of reserves as a fund that can be used in emergency situations; since reserves are on the right-hand side of the balance sheet as liabilities, they do not operate as a fund.<sup>16</sup> However, reserves do protect capital by raising the limit for distributed pay-outs (dividends) to shareholders.<sup>17</sup> In other words, reserves are not permitted to be distributed as dividends.<sup>18</sup>

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<sup>9</sup> MEIER-HAYOZ/FORSTMOSER/SETHE, *Gesellschaftsrecht*, § 16, par. 54 et seqq; MEYER, CONRAD, *Finanzielles Rechnungswesen*, p. 40.

<sup>10</sup> BÖCKLI, *Rechnungslegung*, par. 427; GLANZMANN, *Handels- und Gesellschaftsrecht* § 8 par. 2; KLEINBOLD, *Ausschüttungsregulierung*, p. 121; MEYER, CONRAD, *Finanzielles Rechnungswesen*, p. 40.

<sup>11</sup> GUTSCHE, *veb.ch Praxiskommentar*, Art. 959a, par. 140.

<sup>12</sup> *Ibid.*

<sup>13</sup> Cf. WÖHE/DÖRING/BRÖSEL, *Betriebswirtschaftslehre*, pp 542 et seqq.

<sup>14</sup> Cf. HANDSCHIN, *Rechnungslegung*, par. 100; BOEMLE/STOLZ, *Unternehmensfinanzierung*, pp 11 et seq.12.

<sup>15</sup> BÖCKLI, *SZW* 81/2009, p. 20; BOEMLE/STOLZ, *Unternehmensfinanzierung*, pp 68 et seq.

<sup>16</sup> HANDSCHIN, *Rechnungslegung*, par. 818.

<sup>17</sup> *Ibid.*

<sup>18</sup> Cf. *ibid.* HANDSCHIN's examples – one with a high amount of reserves and the other with a low amount of reserves – illustrates how reserves function and their impact on the assets of a company. See also the examples with higher and lower intrinsic values. HANDSCHIN, *Rechnungslegung*, par. 818 et seqq.

### 1.1.3. Historical Context and Problems

All categories of reserves can be used to protect a company from future financial risks by increasing its creditworthiness and equity, as is in the interest of its shareholders, company members, and creditors.<sup>19</sup> Because the norms were imprecise and incomplete before the revisions came into effect, a company was under no obligation to create reserves, although the general assembly was free to do so.<sup>20</sup> The revised legislation facilitates the creation of reserves.<sup>21</sup>

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Ultimately, the interest in maintaining the internal stability of companies has prevailed at the expense of individual shareholders' right to receive dividends.<sup>22</sup>

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## 1.2. Differences to Similar Concepts

### 1.2.1. False Reserves

Unlike depreciated assets, items whose values merely need to be corrected are not classified as reserves.<sup>23</sup> Besides delcredere reserves, replacement reserves and amortization reserves cannot be classified as real reserves.<sup>24</sup> Delcredere reserves, as an impairment for receivables, are also not classified as a provision,<sup>25</sup> but rather only as an item that corrects the assets on a balance sheet.<sup>26</sup> This is the reason why delcredere reserves are classified as a valuation adjustment.<sup>27</sup>

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<sup>19</sup> ZK-BÜRGI, Art. 670, par. 7.

<sup>20</sup> *Ibid.*, par. 18.

<sup>21</sup> The revisions before 1957. See ZK-BÜRGI, Art. 670 par. 8.

<sup>22</sup> See ZK-BÜRGI, Art. 671, par. 8 and 10 with a reference to BGE 72 II 293.

<sup>23</sup> ZK-BÜRGI, Art. 670, par. 93 et seq.

<sup>24</sup> Cf. ZK-BÜRGI, Art. 670, par. 131.

<sup>25</sup> BGE 113 II 52 consideration 2; BSK II-NEUHAUS-HAAG, Art. 960a, par. 22; BÖCKLI, Rechnungslegung, par. 984.

<sup>26</sup> HWP, p. 140.

<sup>27</sup> Cf. *Ibid.*; HANDSCHIN, Rechnungslegung, par. 727 et seq; see for the terminology par. 728.

## 1.2.2. Provisions

- 17 According to Art. 960e par. 2 CO, provisions are neither liabilities (as defined in Art. 959 par. 5 CO) nor contingent liabilities (as defined in Art. 959c par. 2 no. 10 CO), but instead occupy a position in between these two categories.<sup>28</sup> A provision is a liability that is afflicted with a degree of uncertainty; when it will occur and what its value will be are unclear.<sup>29</sup> Besides this uncertainty, a provision is defined in particular by its provisional or temporary character.<sup>30</sup> To understand the notion of provisions, it is important to show their nature and valuation, how they are created and dissolved, and who has the authority to do so. A final crucial difference is the important role that provisions play in calculating tax. The frequent use of the term “reserves” in this context requires clarification. In a broad sense, provisions can also be seen as a type of reserve, namely for uncertain future cash outflows.<sup>31</sup> As such, following HANDSCHIN, the term “reserves” is more appropriate for describing provisions, because when a company creates provisions, the value of the dividends that can be distributed to the shareholders is also reduced.<sup>32</sup> A provision is also a type of reserve for a risk – the risk of an incorrect current valuation of a liability – thus, to cover a possible cash outflow in the future.<sup>33</sup> Despite the more accurate terminology, the nature of provisions as liability and reserves as equity is very different and is to be differentiated clearly, as for example in Art. 725 par. 1 CO (Art. 725a revOR). The effects and problematic consequences will be shown in [Paragraph 412 et seqq.](#)<sup>34</sup>

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<sup>28</sup> See image in HWP, p. 214.

<sup>29</sup> Cf. HANDSCHIN, Rechnungslegung, Glossar, Rückstellung, p. LXXXI: A provision is a liability of uncertain timing or value. A better definition may be that a provision is a reserve with future cashflow risk. HANDSCHIN, Rechnungslegung, par. 765. According to RIEDERER, the best definition of a provision is in Art. 49 par. 3 FHG, MEYER, CONRAD, Finanzielles Rechnungswesen, p. 347; RIEDERER, p. 31.

<sup>30</sup> Sentenza del Tribunale federale svizzero del 3 luglio 1980 nella causa Amministrazione cantonale dell'imposta per la difesa nazionale contro la Camera di diritto tributario del Tribunale d'appello del Cantone Ticino, published in: ASA 54, 660 pp 672 et seqq: Gli elementi essenziali dell'accantonamento sono quindi l'incertezza, l'indeterminatezza e soprattutto la provvisorietà (consideration 6.a).

<sup>31</sup> WINNEFELD, D par. 871.

<sup>32</sup> Cf. HANDSCHIN, Rechnungslegung, par. 765, Provisions are created for liabilities whose time of fulfilment or value of future cash outflow are uncertain.

<sup>33</sup> HANDSCHIN, Rechnungslegung, par. 728 et seq. and 765 et seqq.

<sup>34</sup> Provisions see [Paragraph 20](#); Reserves see [Paragraph 10](#).



(1) *A Negative Definition*

Like liabilities, provisions are caused by past events while assuming a future cash outflow.<sup>35</sup> Provisions differ from liabilities, however, in the probability of their occurrence, their uncertain value, and the unknown timing of their cash outflows.<sup>36</sup> In contrast to provisions, liabilities must be entered onto the balance sheet as debt capital if they have been caused by past events, if a cash outflow is probable, and if their value can be reliably estimated.<sup>37</sup> For provisions, on the other hand, the unpredictability of their occurrence means that they can be reported as a proportion of the total value.<sup>38</sup> The valuation of reserves differs from the valuation of provisions, for which Art. 960e par. 2 CO states that provisions must be created when they are likely to be required; as a result, proportional reporting is justified.<sup>39</sup>

Another concept that is similar to provisions are contingent liabilities, as defined in Art. 959c par. 2 no. 10 CO. Contingent liabilities are current legal obligations for which a cash outflow either appears unlikely or represents a value that cannot be reliably estimated.<sup>40</sup> This is the case for liabilities that are owed to a third party or when the occurrence of a liability depends on external factors that are not under the control of the company.<sup>41</sup> In such cases, reporting the relevant amount as a liability would not be justified.<sup>42</sup> However, contingent liabilities are listed in the notes, as stipulated in Art. 959c par. 2 no. 10 CO, due to the likelihood that they will occur.<sup>43</sup> By reporting them in the notes, their disclosure as contingent liabilities is no longer necessary.<sup>44</sup> For the sake of a

<sup>35</sup> BSK II-NEUHAUS/HAAG, Art. 960e, par. 2.

<sup>36</sup> *Ibid.*, par. 9 and 14; HWP, p. 213.

<sup>37</sup> Art. 959 par. 5 CO.

<sup>38</sup> HWP, p. 216.

<sup>39</sup> HWP, p. 216; cf. BGer 4A\_277/2010 of 2/9/2010 consideration 2.1; HANDSCHIN has a dissenting opinion, arguing that a proportional reporting is a distortion when a provision is more likely not to occur, and reporting it is distortion of the real probability; in that case it should not have been reported at all. He thus follows the IFRS's 50% rule (IAS 37, Provisions, Contingent Liabilities and Contingent Assets, par. 15). For an example with numbers see HANDSCHIN, Rechnungslegung, par. 776 and 776a.

<sup>40</sup> Art. 959c par. 2 no. 10 CO.

<sup>41</sup> STEFANI, veb.ch Praxiskommentar, Art. 959 par. 51; KESSLER, veb.ch Praxiskommentar, Art. 959c par. 78; CHK Rechnungslegungsrecht-LIPP, Art. 959 par. 73 et seqq.

<sup>42</sup> HANDSCHIN, Rechnungslegung, par. 748.

<sup>43</sup> HWP, p. 138; cf. HANDSCHIN, Rechnungslegung, par. 493.

<sup>44</sup> STENZ, Veb.ch Praxiskommentar, Art. 960e par. 31.

complete differentiation from similar concepts, transitory liabilities are also listed; as transitory liabilities are certain to occur, their value can be precisely appraised.<sup>45</sup>

### (2) *Legal Nature and Characteristics*

- 20 The CO does not address delimitations, but Art. 959a CO does state clearly that provisions are to be reported in the balance sheet as financial liabilities. In contrast, reserves are reported as equity under the assets.<sup>46</sup> In case a cash outflow does occur, it becomes a liability.<sup>47</sup> Because provisions are classified as liabilities, Art. 725 par. 2 CO (Art. 725b par. 1 revCO) states that, in case of over-indebtedness, provisions are counted as the uncovered claims of a company's creditors, regardless of whether the company's assets are appraised at going concern value or liquidation value.<sup>48</sup> Furthermore, provisions must be charged in the profit and loss account and not under the equity.<sup>49</sup>

### (3) *Mandatory Creation and Dissolution*

- 21 According to Art. 960e par. 2 CO, it is mandatory to create a provision if a cash outflow is anticipated. However, if the requirements listed in par. 3 CO are not fulfilled, additional provisions – and thus hidden reserves – can be created voluntarily in relation to the following four areas: regularly incurred expenditure from guaranteed commitments, renovations to tangible fixed assets, restructuring, and securing the long-term prosperity of the company.<sup>50</sup> Because such provisions have the properties of reserves, they should be individually listed and explained.<sup>51</sup>

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<sup>45</sup> MÜLLER/HENRY/BARMETTLER, veb.ch Praxiskommentar, Art. 959a par. 115 et seq.

<sup>46</sup> Art. 959a par. 2 no. 2 lit. c CO; ZÖBELI, p. 144. However, as shown in [Paragraph 17](#), provisions can have the same properties as equity in specific circumstances.

<sup>47</sup> HANDSCHIN, Rechnungslegung, par. 764; see also par. 769-770.

<sup>48</sup> HWP, p. 213; BGE 132 III 564 consideration 5; BGer 4A\_277/2010 of 2/9/2010 consideration 2.

<sup>49</sup> STENZ, veb.ch Praxiskommentar, Art. 960e par. 36; especially in the IFRS, it is permitted to charge the equity with special provisions.

<sup>50</sup> Ibid., Art. 960e par. 43 et seq; Botschaft 2008, p.1714.

<sup>51</sup> HANDSCHIN, Rechnungslegung, par. 783.

Besides such non-mandatory provisions, Art. 960e par. 4 CO allows for the indirect creation of hidden reserves when a potential outflow does not occur or when its value is lower than expected.<sup>52</sup> These hidden reserves are thus not dissolved but left untouched.<sup>53</sup> This occurs because the dissolution of unrequired provisions is not mandatory by law.<sup>54</sup> Preferably, provisions should be reevaluated on every qualifying date of the balance sheet and listed in the notes.<sup>55</sup> 22

#### (4) *The Competence to Create and Dissolve Provisions*

The board of directors has the authority as well as the obligation as per Art. 960e par. 3 CO to create provisions.<sup>56</sup> In contrast, since reserves are considered equity, the general assembly has the authority to create and utilise reserves in the annual general meeting.<sup>57</sup> As shown below, provisions are ultimately in many cases hidden reserves – and thus equity – thereby giving the general assembly the power to decide on their creation and usage.<sup>58</sup> 23

#### (5) *Impact on Taxes*

These different definitions are important due to the decisiveness of the balance sheet for tax purposes.<sup>59</sup> The CO's definition of provisions differs substantially from how provisions are defined in tax law.<sup>60</sup> In tax law, dissolution is clearly defined: when provisions are no longer needed because an expected cash outflow did not occur, they are attributed to the taxable profit.<sup>61</sup> Provisions must thus be checked to confirm that they are still reasonable and that their requirements continue to be met.<sup>62</sup> 24

<sup>52</sup> STENZ, veb.ch Praxiskommentar, Art. 960e par. 43 et seq; Botschaft 2008, p. 1714.

<sup>53</sup> STENZ, veb.ch Praxiskommentar, Art. 960e par. 49.

<sup>54</sup> HANDSCHIN, Rechnungslegung par. 786.

<sup>55</sup> Swiss GAAP FER 23 par. 8, par. 11.

<sup>56</sup> HANDSCHIN, Rechnungslegung, par. 767; Stenz, veb.ch Praxiskommentar, 960e par. 35.

<sup>57</sup> Ibid.

<sup>58</sup> HANDSCHIN, Rechnungslegung, par. 121 and 799; Stenz, veb.ch. Praxiskommentar, Art. 960e par. 53.

<sup>59</sup> Cf. Art. 58 DBG.

<sup>60</sup> Cf. Art. 29 and Art. 63 DBG, BÖCKLI, Rechnungslegung, par. 1069 and 1080; DBG-LOCHER, Art. 29, par. 3 seqq and 21.

<sup>61</sup> Cf. Art. 63 par. 2 DBG.

<sup>62</sup> Urteil 2C\_1168/2016 vom 1/05/2017 E. 3.1; StR 72, 920 S. 921; Urteil 2C\_1082/2014 vom 29/09/2016 consideration 2.1; StE 2016 B 72.14.2 Nr. 48.

- 25 An additional requirement in tax law for dissolution is that an immediate risk of occurrence is necessary, meaning that it is likely to occur within the following financial year.<sup>63</sup> As such, the term “immediate” is understood as a temporal factor.<sup>64</sup> On the other hand, according to BÖCKLI and HANDSCHIN, the term “occurrence” is not related to time but to the overall probability of occurrence, which ultimately corresponds to the requirement in commercial law.<sup>65</sup> Also when tax law does not allow for the creation of provisions, it is mandatory to create a provision that meets the requirements of commercial law.<sup>66</sup> The following examples demonstrate the differences in this regard between commercial law and tax law.

(a) *Impairments*

- 26 Art. 960e par. 3 no. 4 allows for provisions to be used to secure the long-term prosperity of a company, but these provisions do not contain a legal or real liability and represent only an internal commitment.<sup>67</sup> Without a legal or real liability, such provisions are not justified by business needs.<sup>68</sup>

(b) *Reserves*

- 27 The option of creating provisions as stipulated in Art. 29 par. 1 lit. c DBG, for example, does not represent the creation of real provisions. Instead, these are classified as equity that can be used as a privilege for tax purposes.<sup>69</sup> Hence, such a provision – which can be used, for example, for research and development contracts for third parties – is actually a reserve and not a provision.<sup>70</sup>

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<sup>63</sup> Art. 29 par. 1 lit. c; Art. 63 par. 1 lit. c; Botschaft über die Steuerharmonisierung, p. 169.

<sup>64</sup> REICH ET AL. DBG, Art. 29 par. 34.

<sup>65</sup> BÖCKLI, Aktienrecht, § 8 par. 488.

<sup>66</sup> HWP 2009, p. 240; In IFRS accounting other reserves may be established if national tax law grants exemptions from, or reductions in, taxation liabilities when transfers to such reserves are made, IFRS, Framework, 66.

<sup>67</sup> Cf. DBG-LOCHER Art. 29, par. 5 et seqq.

<sup>68</sup> Cf. Botschaft 2008 p. 1711.

<sup>69</sup> BGer 2C\_808/2017 of 29/05/2018 consideration 4.1; StR 73, 794 p. 796; RDAF 74 II, 473 pp 474 et seq.

<sup>70</sup> CHAPUIS/YERLY, ASA 87/2018-19 p. 248.

### 1.3. Hidden Reserves

Reserves are usually subdivided according to their appearance into open and hidden reserves, as discussed in the following chapter.<sup>71</sup> First the current legal status of hidden reserves is problematized and a solution for their disclosure is provided. Later in this work, possible alternatives that could provide a more accurate picture than hidden reserves are considered.

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#### 1.3.1. Nature

Hidden reserves are hidden or covert equity; as such, they represent the difference between the reported and the current existing equity.<sup>72</sup> This added value<sup>73</sup> is difficult to measure before it is reported on the balance sheet.<sup>74</sup> Hidden reserves are thus unreported values in the equity that are intentionally created either through overvalued liabilities or undervalued assets and then legitimised through reporting based on the principle of prudence.<sup>75</sup> On the other hand, forced and discretionary reserves are a logical consequence of the principle of prudence and are temporary only because they have yet to be reported; as such, they represent a simple expectation or possibility of income.<sup>76</sup> Prudence is crystallized in accounting law through the mandatory undervaluation of assets and overvaluation of liabilities.<sup>77</sup> Unlike open reserves, hidden reserves are attributed to a specific asset or liability.<sup>78</sup> From a comparative perspective, it has been established that the Swiss authorities show more tolerance in their version of the Helvetic Glass Bead Game<sup>79</sup> than is common in other countries.<sup>80</sup>

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<sup>71</sup> REICH, Realisation, p. 4; other subdivisions are also possible based on legal or statutory considerations or functions, ZH-BÜRGI, Art. 671 par. 3 et seqq.

<sup>72</sup> HANDSCHIN, Rechnungslegung, par. 852 and 857; MEYER, CONRAD, Finanzielles Rechnungswesen, p. 348; REICH, Realisation, pp 5.

<sup>73</sup> REICH, Realisation, p. 74.

<sup>74</sup> Cf. Ibid., pp 4 and 16.

<sup>75</sup> BÖCKLI, Rechnungslegung, par. 1086 et seqq; BÜHLMANN, par. 1084; For more on discretionary reserves, see [Paragraph 46](#).

<sup>76</sup> REICH, Realisation, p. 24.

<sup>77</sup> Such as in Art. 960a par. 1; Art. 960e par. 2 CO. For more on arbitrary reserves, see [Paragraph 38](#).

<sup>78</sup> REICH, Realisation, p. 5.

<sup>79</sup> Term borrowed from BÖCKLI, Rechnungslegung, par. 634 which refers to Herman Hesse's novel Glass Bead Game.

<sup>80</sup> BEHR, FS Forstmoser, p. 47. For more on international divergence in tax law, see [Paragraph 61](#) below.

### 1.3.2. Historical Functions

- 30 Hidden reserves had a legitimate function as a form of equity preservation, income regulation and self-financing.<sup>81</sup> Especially in times of crisis, a company's own capital could diminish its susceptibility and increase its financial stability.<sup>82</sup> With their function of income regulation, hidden reserves were under the control of the board of directors.<sup>83</sup> The former Art. 663 par. 2 CO (in force until 2012) gave the board a type of power of attorney to create hidden reserves for corporate strategic reasons.<sup>84</sup> This once gave hidden reserves a particular advantage over other types of reserves. By allowing management to react immediately and independently – without having to ask the general assembly – hidden reserves made it possible for crises to be resolved with no recognisable diminution of capital or open reserves.<sup>85</sup> However, this tool was recognised as dangerous due to the manner in which it was abused to dissolve hidden reserves in order to conceal losses for which the board members would be held responsible, and would thus have to explain to the general assembly.<sup>86</sup> However, this criticism was only directed at management reserves, which are now called free or arbitrary reserves, since both forced and discretionary reserves generally arise from the prudence principle and are therefore inherent to the accounting system.<sup>87</sup> Moreover, the resilience to crisis displayed by many companies in the 1930s was due to their numerous hidden reserves.<sup>88</sup> As a result, the dangers of hidden reserves were considered insignificant when compared to the potential benefits that could be gained from their use.<sup>89</sup>

### 1.3.3. Types of Hidden Reserves

- 31 The doctrine divides hidden reserves into three categories according to the reason for their creation.<sup>90</sup>

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<sup>81</sup> REICH, Realisation, pp 16-23.

<sup>82</sup> Ibid., p. 23; ZK-BÜRGI, Art. 670 par. 12.

<sup>83</sup> REICH, Realisation, pp 22-23.

<sup>84</sup> Ibid, p. 11.

<sup>85</sup> BÜRGI-ZH, Art. 671, par. 11.

<sup>86</sup> BK-KÄFER, Art. 960, par. 192; DIETERLE, ASA/46 p. 32.

<sup>87</sup> REICH, Realisation, pp 10, 11 and 24.

<sup>88</sup> Ibid.

<sup>89</sup> Ibid.

<sup>90</sup> Cf. CHK Rechnungslegungsrecht-LIPP, par. 20 et seqq; For BÖCKLI, there are only two categories; see par. X. See HWP for other categories defined by purpose, HWP, p. 245 et seqq.

(1) *Forced Hidden Reserves*

As the term “forced” or compulsory suggests, a company is not at liberty to choose whether forced reserves should be created or not.<sup>91</sup> This occurs especially in the case of non-current fixed assets due to a monetary devaluation, an elevated marked value, or when – in contrast to the acquisition costs – the full value of forced hidden reserves is not reported.<sup>92</sup> Forced hidden reserves are thus the difference between the highest legal value and the real value; as such, they result from the cost value principle, according to which assets are to be valued at the highest acquisition cost.<sup>93</sup> 32

The existence of such forced reserves has no impact on profit and loss, and therefore does not distort a period’s profit.<sup>94</sup> Forced hidden reserves do not fall under the categories of hidden reserves that need to be disclosed in the notes for the accounts.<sup>95</sup> Forced hidden reserves are not codified in the articles concerning hidden reserves in the CO.<sup>96</sup> However, there is one important exception when they are codified: cases of revaluation in crisis situations.<sup>97</sup> 33

According to Art. 725c revCO (Art. 670 CO), a company may revalue land, buildings, or equity participations whose real value has risen above the stated cost value – up to a maximum value equivalent to one-half of the share capital – in order to rectify negative net worth in a crisis situation in which the company’s capital cover falls beneath one-half of its share capital and legal reserves.<sup>98</sup> Hence, Art. 725c par. 1 revCO allows for the revaluation of land, buildings or equity participations containing hidden free reserves to its real value with the goal of avoiding over-indebtedness, capital loss and, in particular, the ultimate need to undergo the financial restructuring measures outlined in Art. 725 par. 1 CO.<sup>99</sup> Outside the scope of Art. 725c par. 1 revCO, revaluation is only allowed up to the value of the acquisition cost.<sup>100</sup> In contrast, assets with a stock ex- 34

<sup>91</sup> HANDSCHIN, Rechnungslegung, par. 853; Botschaft 1983, p. 812, par. 209, no. 43.

<sup>92</sup> HWP, p. 245; BÖCKLI, Aktienrecht, § 8 par. 890; BÖCKLI, Rechnungslegung, par. 1086.

<sup>93</sup> Cf. BSK II-NEUHAUS HAAG, Art. 960a par. 29.

<sup>94</sup> BÖCKLI, Rechnungslegung, par. 1086.

<sup>95</sup> Art. 959c par. 1 CO; HWP, p. 305.

<sup>96</sup> BÖCKLI, Rechnungslegung, par. 1094.

<sup>97</sup> HWP, p. 305.

<sup>98</sup> Cf. Art. 725c revCO (Art. 670 CO).

<sup>99</sup> HANDSCHIN, Rechnungslegungsrecht, par. 861; BSK II-NEUHAUS/BALKANYI, Art. 670 par. 2.

<sup>100</sup> Cf. Art. 960a par. 2.

change price or another observable market price may be valued at that price as per the date of the balance sheet, even if this price exceeds the nominal value or the acquisition value.<sup>101</sup>

- 35 Art. 725c par. 1 revCO (Art. 670 CO), which operates outside the norms of financial accounting, also allows for a revaluation of land, buildings, or equity when a limited liability company is in crisis, thus breaching the imparity and realisation principles by making use of the maximum valuation rules, a legally codified norm.<sup>102</sup> This activation of free hidden reserves for land, buildings, or equity participations has proven to be an unquestionable benefit for companies in crisis.<sup>103</sup>
- 36 Revaluation must satisfy both substantive and formal criteria. Substantively, revaluation may not exceed the real value,<sup>104</sup> which assumes that the real value is above the carrying value or the acquisition cost.<sup>105</sup> From a formal perspective, the auditors must confirm to the general assembly that there is a crisis situation.<sup>106</sup> In relation to the question of the revaluation's impact on profit and loss, the divergence between corporate law and tax law is noteworthy. In tax law, revaluation is recognised through the profit and loss account, on which it thus has an impact.<sup>107</sup>
- 37 According to commercial law, in contrast, revaluation does not affect the profit and loss account.<sup>108</sup> Finally, a revaluation reserve, a type of open reserve, that corresponds to the revaluation amount must be listed separately, as stipulated Art. 725c par. 1 in fine revCO (Art. 670 CO).<sup>109</sup>

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<sup>101</sup> Art. 960b par. 1 CO. See the table of comparison in HÜTTICHE, *veb.ch Kommentar*, Art. 960b par. 40.

<sup>102</sup> Botschaft 2017, p. 522; Botschaft 2007, p. 1658; its removal was proposed in 2007. Vorentwurf zur Revision des Aktienrechts von 2014, p. 142. For the revised norm, see Art. 725c revCO; HÜTTICHE, *veb.ch Kommentar* 960b par. 39 et seq. Ultimately, it was moved to an appropriate section after the rules for companies limited by shares in crisis situations.

<sup>103</sup> Cf. BÖCKLI, *Rechnungslegung*, par. 488; cf. GLANZMANN, *SJZ* 108/2012, p. 211; cf. HANDSCHIN, *Rechnungslegung*, par. 861.

<sup>104</sup> Botschaft 1983, p. 894; HWP, p. 303.

<sup>105</sup> BSK II-NEUHAUS/BALKANYI, Art. 670, par. 10.

<sup>106</sup> Cf. ZK-BÜRGI, Art. 670 par. 2 CO; Botschaft 2017, p. 894; HWP, p. 305.

<sup>107</sup> BÖCKLI, *Rechnungslegungsrecht*, par. 486. According to Art. 58 par. 1 lit c DBG the net profit is elevated.

<sup>108</sup> BÖCKLI, *Rechnungslegungsrecht*, par. 486.

<sup>109</sup> The revaluation amount is disclosed as a retained earnings reserve, as will be shown below in [Paragraph 129](#).



## (2) *Arbitrary Hidden Reserves*

Arbitrary hidden or free hidden reserves are permitted according to the CO<sup>110</sup> or customary law; however, they are not justified by the principle of prudence outlined in the CO.<sup>111</sup> Formerly also known as management reserves<sup>112</sup> or intentional reserves,<sup>113</sup> free hidden reserves represent the difference between the highest legal value and its deliberately underreported carrying value.<sup>114</sup> As the name indicates, a company is free to decide if it wants to create a free hidden reserve and thus improve its financial situation.<sup>115</sup> The following types of reserves are categorized as arbitrary hidden reserves.<sup>116</sup> 38

### (a) *Reserves for Replacement Purposes*

According to Art. 960a par. 4 CO, reserves may be created while making additional depreciation and valuation adjustments for replacement purposes in order to ensure the long-term prosperity of the company.<sup>117</sup> Reserves thus appear due to valuation adjustments that are greater than necessary.<sup>118</sup> However, the legislation's intent to allow this practice of creating hidden reserves results in a contradiction with the requirements of financial reporting, which demand that a company must accurately represent its financial position so that third parties can make a reliable assessment thereof.<sup>119</sup> In any case, the CO's draft permitted valuation adjustments only in accordance with real adjustments and forbade any anticipations of loss.<sup>120</sup> 39

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<sup>110</sup> Art. 960a par. 4 CO; Art. 960e par. 3 no. 4 and par. 4 CO; Art. 959c par. 1 no. 3 CO.

<sup>111</sup> HWP, p. 245 et seqq.

<sup>112</sup> *Ibid.*, p. 245.

<sup>113</sup> Cf. BOEMLE/LUTZ, pp 172 et seq.

<sup>114</sup> HWP, p. 245.

<sup>115</sup> Cf. CHK Rechnungslegungsrecht-LIPP, par. 21.

<sup>116</sup> Cf. HANDSCHIN, Rechnungslegung, par. 855.

<sup>117</sup> Cf. BSK II-NEUHAUS HAAG, Art. 960a par. 3.

<sup>118</sup> Cf. *Ibid.*, Art. 960a par. 29.

<sup>119</sup> Cf. Art. 958 par. 1 CO; cf. BSK II-NEUHAUS HAAG, Art. 960a par. 28.

<sup>120</sup> Cf. BSK II-NEUHAUS HAAG, Art. 960a par. 28.

(b) *Reserves That Ensure the Long-Term Prosperity of a Company*

- 40 In addition to replacement purposes, Art. 960a par. 4 CO also allows the creation of free hidden reserves in order to ensure the long-term prosperity of a company through making additional depreciation and valuation adjustments. As such, a company in a crisis situation may access its hidden reserves and improve its balance sheet by eliminating any over-indebtedness in its carrying values.<sup>121</sup>

(c) *Extended Provisions*

- 41 Provisions that secure the long-term prosperity of a company may be created even if the requirements for the creation of provisions are not fulfilled and these provisions are therefore not operationally necessary.<sup>122</sup> Such provisions are not classified as third-party liabilities; instead, they count towards a future period,<sup>123</sup> opening up the possibility of creating unlimited hidden reserves.<sup>124</sup> As such, Art. 960e par. 3 no. 4 CO effectively allows for the indirect creation of hidden reserves.

(d) *Provisions that are no longer required*

- 42 Unlike provisions created according to Art. 960 par. 3 no. 4 CO in the above-described manner, the other provisions outlined in par. 3 do not represent hidden reserves in the same way. Only once they are no longer needed – due to a risk that was not realised – do they constitute hidden reserves, assuming that they have not been cancelled.<sup>125</sup> At this point, these hidden reserves represent a company's undisclosed equity.<sup>126</sup> For the same reason, according to Art. 960a par. 4 Cl. 2 CO, it is not necessary to cancel depreciation and valuation adjustments that are no longer required or justified.

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<sup>121</sup> HANDSCHIN, Rechnungslegung, par. 860. For example, exaggerated valuation adjustments can be revaluated to the value of the acquisition cost at any time. Provisions that are no longer needed due to the cancellation of a risk may be dissolved through profit and loss, par. 729 et seqq and 786.

<sup>122</sup> Cf. BSK II-NEUHAUS-HAAG, Art. 960e par. 15 and 19.

<sup>123</sup> BSK II-NEUHAUS-HAAG, Art. 960e par. 24.

<sup>124</sup> STENZ, veb.ch Kommentar, Art. 960e par. 48.

<sup>125</sup> Cf. BSK II-NEUHAUS-HAAG, Art. 960e par. 19.

<sup>126</sup> STENZ, veb.ch Kommentar, Art. 960e par. 41 and 49.

*(e) Addendum: Continuous Distribution of Dividends?*

One may question whether reserves should be used to ensure a continuous distribution of dividends or should take into account the broader interests of the shareholders. The aim of ensuring a continuous distribution of dividends by paying out lower dividends in good years is criticized in the doctrine.<sup>127</sup> The main problem with this practice is its lack of transparency<sup>128</sup> and its ultimate potential to mislead the shareholders – the owners of the company – by using this category of hidden reserves to withhold information about the company's genuine financial situation.<sup>129</sup> Although the authority to decide on the distribution of dividends should lie with the general assembly,<sup>130</sup> this option was removed in the revised accounting legislation.<sup>131</sup>

However, the passage referring to the “consideration of the shareholder’s interests” was also erroneously removed by the legislation and, with it, the substantive requirement for the creation of any type of free hidden reserves.<sup>132</sup> Due to the principles anchored in Art. 717 par. 2 CO and 706 par. 2 no. 3 CO, any decision on the distribution of dividends must be made in consideration of the interests of the minority shareholders.<sup>133</sup> Whereas minority shareholders have an interest in an adequate distribution of dividends, the majority shareholders are more interested in the artificial reduction of the annual profit.<sup>134</sup>

In my opinion, continuous distributions are also guaranteed by corporate law; as such, the creation of hidden reserves that disregard the interests of the shareholders breaches their rights as guaranteed in corporate law.

*(3) Discretionary Reserves*

Like arbitrary reserves, discretionary reserves represent the difference between the highest legal value and a deliberately underreported carrying value.<sup>135</sup> The creation of discretionary reserves is characterized by using what

<sup>127</sup> BÖCKLI, Aktienrecht, § 8 par. 905 et seq. See HANDSCHIN, Rechnungslegung par. 862 et seq. for a good example thereof.

<sup>128</sup> HANDSCHIN, Rechnungslegung, par. 864.

<sup>129</sup> Botschaft 2007, p. 1662, par. 2.1.12.

<sup>130</sup> HANDSCHIN, Rechnungslegung, par. 864.

<sup>131</sup> BÖCKLI, Rechnungslegungsrecht, par. 1111; Botschaft 2007, p. 1662, par. 2.1.12.

<sup>132</sup> In 2011, Art. 669 par. 3 CO (1991) was removed.

<sup>133</sup> BÖCKLI, Schweizer Aktienrecht, § 8 par. 904 and 906.

<sup>134</sup> Botschaft 1983, 815, par. 209 no. 47.

<sup>135</sup> CHK Rechnungslegungsrecht-LIPP, par. 20 et seqq.

is allowed and can be justified by the prudence principle.<sup>136</sup> This permits assets to be undervalued and liabilities to be overvalued for reasons of prudence.<sup>137</sup> According to BÖCKLI, there is no particular form of prudence other than that expressed in the prudence principle; consequently, a less optimistic valuation will result in the creation of a type of free reserves.<sup>138</sup> In any case, discretionary reserves should be considered as a separate category of hidden reserves.

#### (4) *Prohibited Hidden Reserves*

- 47 Prohibited hidden reserves differ from legal hidden reserves in the manner by which they are created in the sense that they have no legal basis and consequently their creation is not disclosed. Whereas legal reserves are created as stipulated in the CO, prohibited reserves arise from fictitious debts or undisclosed values,<sup>139</sup> namely expenses evidenced by a false invoice – including a false date or name – for non-existent foreign suppliers that did not render any service.<sup>140</sup> Such practices may even be subject to criminal prosecution.<sup>141</sup> According to BÖCKLI, the non-dissolution of unrequired provisions or ultimately unrealised risks is an exception in the CO due to its punishability.<sup>142</sup>

#### (5) *Addendum: Cookie Jar Reserves in Common Law*

- 48 Cookie jar reserves are used in so-called cookie jar accounting, a practice of reporting lower income or debiting a larger-than-necessary amount for an earlier period.<sup>143</sup> This results in an artificially low income, allowing management to report an inflated income – colloquially known as a cookie jar – for a later period.<sup>144</sup> Cookie jar reserves, which are more formally known as secret reserves, were commonly used in the period from about 1890 to 1920 in the

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<sup>136</sup> HWP, p. 245; BSK OR II-NEUHAUS/HAAG, Art. 960a par. 29.

<sup>137</sup> Botschaft 1983, 812, par. 209 no. 43. For an object with a useful life of between three and six years, for example, depreciation is only allowed to take into account a useful life of three years. HANDSCHIN, Rechnungslegungsrecht, par. 854.

<sup>138</sup> BÖCKLI, Rechnungslegungsrecht, par. 1088.

<sup>139</sup> HANDSCHIN, Rechnungslegungsrecht, par. 865; BGE 92 II 243 consideration 3.

<sup>140</sup> BÖCKLI, Rechnungslegung, par. 1100.

<sup>141</sup> Prohibited free reserves can lead to forgery, as outlined in Art. 251 StGB; BSK StGB II-BOOG; Art. 251, par. 95; BGE 132 IV 12 consideration 8.3. For criminal tax law, see BÖCKLI, Rechnungslegung, par. 317 et seq.

<sup>142</sup> Ibid., par. 1104.

<sup>143</sup> WEIL/SCHIPPER/FRANCIS, p. 756.

<sup>144</sup> Ibid.

United States; only after World War I did they come to be seen as misleading to investors.<sup>145</sup> The Board of Trade in the United Kingdom, however, created the Company Law Amendment Committee in 1929 that considered the use of secret reserves to smooth earnings.<sup>146</sup> In the United States during World War II, secret reserves were known as special war reserves, since they were meant to cover the cost of unexpected contingencies arising from the war effort.<sup>147</sup>

Ultimately, the FASB announced in 1990 that it would henceforth be necessary for companies to disclose contingency reserves in footnotes to financial statements, thus effectively banning secret reserves.<sup>148</sup> I regard cookie jar reserves as a general term for these prohibited secret reserves, not for disclosed reserves and provisions.

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### 1.3.4. Creation

It has been shown that different types of reserves are distinguished from each other by the manner in which they are created. Since hidden reserves represent equity, it is thus crucial to consider which body or organ has the authority to create them while remembering that they are not neutral to the profit and loss account.

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#### (1) *Impact on Profit and Loss Account*

The creation of hidden reserves affects the profit and loss account and therefore reduces the profit that would have been distributed to the shareholders.<sup>149</sup> Generally, the creation of hidden reserves is not compatible with the aims of reporting due to their impact on the profit and loss account, which is intended to present the financial position of a company in such a manner that third parties can make a reliable assessment thereof.<sup>150</sup> In other words, while valuation should be carried out prudently, this must not prevent the reliable assessment of a company's financial position.<sup>151</sup> The profit and loss account should present the earnings of the company over the course of the financial year; however, as the profit and loss account is distorted by the creation of reserves, this con-

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<sup>145</sup> MARKHAM, p. 217.

<sup>146</sup> Ibid.

<sup>147</sup> Ibid.

<sup>148</sup> Ibid.

<sup>149</sup> HANDSCHIN, Rechnungslegung, par. 875.

<sup>150</sup> Art. 958 par. 1 CO; cf. HANDSCHIN, Rechnungslegung, par. 876.

<sup>151</sup> Art. 960 par. 2 CO; cf. CR-TORRIONE/BARAKAT, Art. 960 par. 38 and 39.

travenes the fundamental rules of financial accounting.<sup>152</sup> In addition to this breach of the principles of financial accounting, the creation of reserves also breaches the rules for companies limited by shares, according to which the board of directors has an obligation to strive for profit.<sup>153</sup>

## (2) Competence

52 The partner conference has the legal authority to create hidden reserves in a simple partnership, general partnership, or limited partnership, because this decision goes beyond a simple execution of accounting rules and concerns the share of the profits of all the partners.<sup>154</sup> Like for a company limited by shares, the board of directors of a limited liability company and the management of a cooperative are responsible for the creation of reserves.<sup>155</sup> As shown above in [Paragraph 29](#) on the nature of hidden reserves, they are hidden equity.

53 Thus, decisions on issues such as distributing dividends or increasing or reducing the capital stock are the responsibility of the general assembly and not the board of directors. It is for this reason that accounting law allows for the almost unlimited creation of additional hidden reserves through a transfer of competences from the usual decision-making body.<sup>156</sup>

### 1.3.5. Dissolution

54 The release of hidden reserves is a particularly critical process, because – if performed incorrectly – it can lead to a profit being shown that presents a company's finances in an artificially good light.<sup>157</sup> It is thus important to differentiate between dissolutions which are neutral to the profit and loss account and those which affect it.

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<sup>152</sup> Art. 959b par. 1 sentence 1 CO; BÖCKLI, Rechnungslegung, par. 1113 et seqq.

<sup>153</sup> Cf. BSK II-NEUHAUS/GERBER, Art. 959c par. 18; cf. BSK II-NEUHAUS/HAAG, Art. 960a par. 28.

<sup>154</sup> HANDSCHIN, Rechnungslegung, par. 162 and 165.

<sup>155</sup> Ibid., par. 874.

<sup>156</sup> STENZ, veb.ch Kommentar, Art. 960e CO, par. 50 and 53. See par. 61 for more on further problems that arise as a result of the divergence between accounting law and tax law.

<sup>157</sup> GLANZMANN, Gesellschafts- und Handelsrecht, § 25 par. 182. For more on disclosure, see par. 57 et seqq.

### (1) *Neutral to the Profit and Loss Account*

When hidden reserves are dissolved in such a way that a provision is once again required, the profit and loss account remains unaffected.<sup>158</sup> As this kind of dissolution is not critical, it will not be discussed any further. 55

### (2) *Affecting the Profit and Loss Account*

A dissolution that occurs voluntarily and is based on the decision of the board to artificially improve its profit is critical<sup>159</sup> because chronic weakness of profit can be hidden through continuous dissolution of hidden reserves over a long period of time.<sup>160</sup> Hidden reserves can be dissolved in different ways: through the sale of goods or commodities which have been reported under their real price (realisation of hidden reserves);<sup>161</sup> the in-house sale of goods above their value or their simple dissolution in the books;<sup>162</sup> the change in classification of a free provision<sup>163</sup> from a hidden equity to a mandatory provision (and thus a liability);<sup>164</sup> a change of the valuation system or methodology; or a change in the scope of discretion.<sup>165</sup> 56

## 1.3.6. Disclosure

### (1) *Mandatory Disclosure de lege lata*

The subdivision of reserves is important for the question of which reserves should be disclosed in the notes when they are dissolved. The obligation to provide a disclosure in the notes only concerns free or arbitrary reserves rather than all types of reserves.<sup>166</sup> Forced reserves, which are not under the discretion of the company and consequently cannot be created voluntarily, are not required to be disclosed.<sup>167</sup> 57

<sup>158</sup> BÖCKLI, Rechnungslegung, par. 1118.

<sup>159</sup> Also Ibid., Rechnungslegung, par. 1118 et seqq.

<sup>160</sup> Amtl. Bull. NR vom 1. Oktober 1985, p. 1662.

<sup>161</sup> This leads to a profit for the company by postponing the realisation of its hidden reserves. For a numerical example, see HANDSCHIN, Rechnungslegung par. 878.

<sup>162</sup> BÖCKLI, Rechnungslegung, par. 1120 et seqq.

<sup>163</sup> Art. 960e par. 3 no. 4 or par. 4 CO.

<sup>164</sup> Art. 960e par. 2 CO.

<sup>165</sup> Cf. HWP, p. 185 et seqq.

<sup>166</sup> BSK II-NEUHAUS-GERBER, Art. 959c, par. 16 et seqq.

<sup>167</sup> HWP, p. 246; BÖCKLI, Rechnungslegungsrecht, par. 929.

58 Similarly, discretionary reserves do not fall under this requirement, because they arise out of the prudence principle.<sup>168</sup> Art. 959c par. 1 no. 3 CO states that the notes must indicate the total value of the replacement reserves used as well as that of the additional hidden reserves, if this exceeds the total value of new reserves of the same type, and the result thereof is considerably more favourable. Hence, the legislation only demands the disclosure of the difference between the dissolved reserves and the newly created reserves, although this is actually a violation of the offsetting prohibition.<sup>169</sup> Correctly, HANDSCHIN calls for the disclosure of former reserves as well as newly created reserves, because there is a risk that a company could hide dissolved reserves by offsetting supposedly newly created reserves with those which have actually been dissolved.<sup>170</sup> Disclosure is only mandatory if the result achieved by offsetting the reserves is considerably more favourable.<sup>171</sup> The adverb “considerably” indicates a threshold value of 10-20%<sup>172</sup> of the result.<sup>173</sup> In the banking sector, the threshold value is only 2% of the equity or 20% of the period’s profit.<sup>174</sup> The term “considerably” is not the most adequate, however, since its technical meaning has already been established.<sup>175</sup> As with the principles of financial accounting, the requirement to observe the principle of consistency and the offsetting prohibition, in particular, can make disclosure a powerful legal instrument.<sup>176</sup> Additionally, the principles of financial accounting, especially accrual accounting, indirectly force the company to indicate the dissolution of a hidden reserve and then declare it as undissolved in the same period in which it was created.<sup>177</sup>

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<sup>168</sup> BSK II-NEUHAUS-GERBER, Art. 959c, par. 18.

<sup>169</sup> HANDSCHIN, Rechnungslegung, par. 882 and 887. In contrast, a disclosure is not mandatory when more reserves are created than dissolved. HANDSCHIN, Rechnungslegung, par. 887.

<sup>170</sup> Cf. HANDSCHIN, Rechnungslegung, par. 882. See the examples in HANDSCHIN, Rechnungslegung, par. 882 et seqq.

<sup>171</sup> Art. 959c par. 1 no. 3 CO.

<sup>172</sup> CHK Rechnungslegungsrecht-LIPP, Art. 958c par. 25 et seqq; CR-TORRIONE/ BARAKAT, Art. 959c par. 15; BSK II-NEUHAUS/GERBER, Art. 959c par. 21; HANDSCHIN par. 887. Divergent percentage: between 5-20%, KESSLER/PFAFF, veb.ch Kommentar, Art. 959c par. 30.

<sup>173</sup> The meaning of the term “result” is contested. According to HANDSCHIN, the result is the net profit. In BÖCKLI’s opinion, it is the annual profit after the observable differences in the annual profit caused by the dissolution of free reserves have been deducted, HANDSCHIN, Rechnungslegung, par. 887; BÖCKLI, Rechnungslegung par. 636.

<sup>174</sup> FINMA-Circ 2015/1 par. 255. See par. 316 et seqq for the regulations.

<sup>175</sup> FORSTMOSER, SZW 64/1992, p. 68.

<sup>176</sup> HANDSCHIN, Rechnungslegung, par. 887.

<sup>177</sup> Ibid., par. 889a.



## (2) *Free Disclosure de lege feranda*

Companies which strive for greater levels of transparency are free to provide additional information, such as on the creation or dissolution of reserves, in their annual financial statements.<sup>178</sup> Furthermore, both hidden and open reserves that capture valuation insecurities<sup>179</sup> can also be shown. Technically, this could occur when creating open valuation reserves in the form of an open reserve instead of creating hidden reserves through the creation of excessive valuation adjustments.<sup>180</sup> It could also occur when assets with a stock exchange price or another observable market price in an active market are overvalued, thus creating a fluctuation or revaluation reserve.<sup>181</sup> Hence, a company should consider all options and benefits in this regard offered by accounting law.

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## (3) *Associates' Request for Disclosure*

Art. 962 par. 2 CO gives the opportunity to request financial statements prepared in accordance with a recognised standard to associates and company members who represent at least 20% of the basic capital and 10% of cooperative members or 20% of the members of an association as well as any cooperation member subject to personal liability or a duty to pay in further capital. A financial statement's compliance with the recognised standard must be verified by a qualified audit specialist after a standard audit.<sup>182</sup> The right to request a financial statement does not depend on the company's legal status or category.<sup>183</sup> If the request is not executed, it can be enforced through a court order based on an analogous application of Art. 699 par. 4 CO (Art. 699 par. 5 revCO).<sup>184</sup> As result, minority associates and company members reaching the required percentage according to Art. 962 par. 2 CO can compel a company to disclose its hidden reserves.<sup>185</sup>

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<sup>178</sup> Cf. FONTANA/HANDSCHIN, ST 88/2014 p. 654.

<sup>179</sup> See reevaluation reserve in [Paragraph 68 et seqq](#) and fluctuation reserve in [Paragraph 86 et seqq](#).

<sup>180</sup> This is explained above in [Paragraph 28 et seqq](#).

<sup>181</sup> HANDSCHIN, Rechnungslegung, par. 891.

<sup>182</sup> Art. 962a par. 2 CO.

<sup>183</sup> BSK II-NEUHAUS/KUNZ, Art. 962 par. 21.

<sup>184</sup> BÖCKLI, Rechnungslegung, par. 1152; for further information on the analogous application of Art. 699 par. 4 CO, see BÖCKLI, Aktienrecht, § 12 par. 73.

<sup>185</sup> HANDSCHIN, Rechnungslegung, par. 889.

### 1.3.7. Impact on Taxes

- 61 The authoritativeness<sup>186</sup> of the profit and loss account is not absolute but only basic or applicable in principle.<sup>187</sup>

#### (1) *Commercially Unjustified Expenses*

- 62 According to the accounting rules, tax law may be invoked to correct the calculated profit by subtracting expenses that are not commercially justified.<sup>188</sup> As it is impossible to draw up a comprehensive list of commercially unjustified expenses, the norm in Art. 58 par. 1 lit. b DBG is a general clause.<sup>189</sup> Tax law intervenes through this norm, especially when depreciations and provisions<sup>190</sup> are created in order to correct commercially unjustified expenses; commercially unjustified expenses can lead to a diminution of income in violation of the principle of periodicity.<sup>191</sup>
- 63 Furthermore, Art. 63 par. 2 DBG states that provisions which have been created but are no longer commercially justified are counted as profit, which is subject to taxation.<sup>192</sup> Free or arbitrary hidden reserves are usually not recognised in tax law, with only a value adjustment or valuation adjustment of the stock<sup>193</sup> permitted.<sup>194</sup> Although this is called a stock reserve, it is not a reserve but a blank value adjustment or valuation adjustment of one-third of the book value recognised in the profit and loss account.<sup>195</sup> Blank value adjustments on debtors of 5%-10%, which are known as declared reserves, are also recognised by the tax authorities.<sup>196</sup> While discretionary reserves are recognised, the principle of prudence and the criteria for what is allowed through prudent report-

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<sup>186</sup> BGer 2C\_429/2010 of 9/8/2011; REICH, Realisation, pp 41-43.

<sup>187</sup> DBG-LOCHER, Art. 58, par. 2 and 9.

<sup>188</sup> Cf. Art. 58 par. 1 lit. b DBG; cf. BSK DBG-BRÜTLISAUER/MÜHLEMANN, Art. 58 DBG par. 2 and 8; cf. REICH, Realisation, p. 43.

<sup>189</sup> BSK DBG-BRÜTLISAUER/MÜHLEMANN, Art. 58 DBG par. 181.

<sup>190</sup> See Art. 960a par. 3 and 4 CO as well as Art. 960e par. 3 and 4 CO.

<sup>191</sup> BSK DBG-BRÜTLISAUER/MÜHLEMANN, Art. 58, par. 196.

<sup>192</sup> See also Art. 62 par. 4 DBG for write downs.

<sup>193</sup> In German: Warendrittel or Warenlagerreserve.

<sup>194</sup> HANDSCHIN, Rechnungslegung, par. 866.

<sup>195</sup> Ibid., par. 723 et seqq.

<sup>196</sup> HWP, p. 204; MÄUSLI-ALLENSPRACH/OERTLI, p. 102.

ing is not understood in the same way in accounting law and tax law.<sup>197</sup> As such, some hidden reserves are subject to taxation while others are not; those which are not recognised by the tax authorities, must be added to the income.<sup>198</sup>

## (2) *Realisation of Hidden Reserves*

Further income that is not reported in the profit and loss account, as well as capital profit, liquidation profit and revaluation profit are also classified as fiscal profit.<sup>199</sup> This incomplete list of corrections of accounting rules falls under the term “realisation of hidden reserves”. For example, capital profit represents a real realisation of hidden reserves, while revaluation profit represents an account realisation in the books.<sup>200</sup>

Instituting a tax-systematic realisation of hidden reserves is important, especially for internal cases in which a reduction in tax substrate should be prevented. The end result of this process is categorized as an anticipated realisation of profit.<sup>201</sup> As this represents a breach of the authoritative principle, the process of tax systematic realisation should only be applied restrictively.<sup>202</sup> Here again, it becomes apparent that accounting law differs from tax law and that the latter intervenes in correcting the accounting rules.<sup>203</sup>

<sup>197</sup> GURTNER, ST 84/2010, pp 385 et seqq.

<sup>198</sup> MÄUSLI-ALLENSPRACH/OERTLI, pp 104-105.

<sup>199</sup> Art. 58 par. 1 lit. c DBG.

<sup>200</sup> Cf. BSK DBG-BRÜTLISAUER/ MÜHLEMANN, Art. 58 DBG par. 389; REICH, *Realisation*, pp 102-104.

<sup>201</sup> Cf. BSK DBG-BRÜTLISAUER/ MÜHLEMANN, Art. 58 DBG par. 389-393. For more detailed information, see REICH, *Realisation*, pp 123-141.

<sup>202</sup> BSK DBG-BRÜTLISAUER/MÜHLEMANN/KUHN/DIETSCHI, Art. 58 par. 395 with further references.

<sup>203</sup> See [Paragraph 17](#) on provisions.



## 2. Classification of Open Reserves

### 2.1. Subdivisions in the Code of Obligations

Generally open reserves are divided in statutory reserves ([2.1.1. Accounting Reserves](#) and [2.1.2. Legal Reserves](#)) and reserves at the discretion of the general assembly. For an overview see the table in [Paragraph 154](#).

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#### 2.1.1. Accounting Reserves

Accounting reserves, like legal reserves, are statutory reserves.<sup>204</sup> As with revaluation reserves for land, buildings or equity participations, or fluctuation reserves and negative reserves for own equity participations, accounting reserves are governed by special rules in accounting law that regulate their creation and dissolution.<sup>205</sup> The board of directors has the competence and authority to create and dissolve accounting reserves due to their responsibility for the organisation of a company's accounting, financial control, and financial planning systems.<sup>206</sup> In general, the creation or dissolution of accounting reserves (revaluation reserve and negative reserves) is a statutory duty rather than falling under the discretion of management.<sup>207</sup> However, the creation of fluctuation reserves is entirely voluntarily.<sup>208</sup>

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##### (1) Revaluation

As shown in [Paragraph 34 et seq.](#) discussing forced hidden reserves,<sup>209</sup> when a company's assets minus liabilities do not cover one-half of the sum of its share capital and refundable capital reserves as well as retained earnings reserves in the last annual balance sheet,<sup>210</sup> it has the option of revaluating land, buildings or equity participations whose real value has risen above its value stated at cost – up to a maximum equivalent to one-half of its share capital and legal

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<sup>204</sup> HANDSCHIN, Rechnungslegung, par. 826.

<sup>205</sup> Ibid., par. 822.

<sup>206</sup> Art. 716a Abs. 1 no. 3 CO for companies limited by shares and Art. 801 CO for limited liability companies.

<sup>207</sup> Cf. BÖCKLI, Aktienrecht, § 8 par. 316-317; MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 106.

<sup>208</sup> HANDSCHIN, Rechnungslegung, par. 615.

<sup>209</sup> See [Paragraph 32](#).

<sup>210</sup> Art. Art. 670 CO (Art. 725c revCO) with a reference to Art. 725 Abs. 1 CO (Art. 725 par. 1 revCO).

reserves – in order to rectify its negative net worth.<sup>211</sup> This regulation aims to prevent the opening of bankruptcy proceedings against a company based on over-indebtedness according to its book value if the company would not have been declared over-indebted according to its real value.<sup>212</sup> According to Art. 725c par. 1 in fine revCO (Art. 670 par. 1 in fine CO), a corresponding amount must be listed separately as a revaluation reserve, the creation of which is thus mandatory.<sup>213</sup> The aim of this reserve is to ensure the threshold of distributable profit is not lowered through the revaluation.<sup>214</sup> This protective effect will be the subject of [Paragraph 74](#) in this chapter. That argument is not convincing because of the conflict with the principle of capital preservation in the CO. Thus, in this work the previous regulation is preferred.

### (a) Historical Origins

- 69 The option of revaluation was introduced into the CO in 1991.<sup>215</sup> Previously, the practice of revaluating land, buildings and equity participations, and thus offsetting losses was known to be used but was clearly illegal.<sup>216</sup> Although the new norms do not allow for offsetting, they have created a legal exception to the imparity principle by permitting revaluation and the consequent reporting of – not yet – realised or future profits from the sale of assets.<sup>217</sup> For BÖCKLI, revaluation reserves are a creation of the Swiss Parliament<sup>218</sup> that offer entities in financial crisis the benefit of being able to revalue assets like land, buildings and equity contributions by reporting the hidden reserves on these assets.<sup>219</sup>
- 70 Revaluation reserves were due to be removed from the 2007 draft. A major reason for this was that land, buildings or equity participations could be sold, through which added value – namely, the difference between the carrying value or book value and the fair value – could be realised.<sup>220</sup> Assets not needed

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<sup>211</sup> Art. 725c par. 1 revCO (Art. 670 par. 1 CO).

<sup>212</sup> ZK-BÜRGI, Art. 670, par. 3.

<sup>213</sup> BSK II-NEUHAUS/BALKANYI, Art. 670 par. 13; HWP, p. 304.

<sup>214</sup> ZK-BÜRGI, Art. 670, par. 3 and 19 et seqq for an explanation of how this reserve functions.

<sup>215</sup> Botschaft 1983, p. 894.

<sup>216</sup> Ibid.

<sup>217</sup> Ibid.

<sup>218</sup> See for more criticism: BÖCKLI, Aktienrecht, § 8 par. 325 et seqq. and 387 and 770.

<sup>219</sup> BÖCKLI, Rechnungslegung, par. 488; HANDSCHIN, Rechnungslegung par. 663; GLANZMANN, SJZ 108/2012, pp 205 et seqq.

<sup>220</sup> Art. 670 CO and Art. 671b CO (this norm will be deleted and is in force until 31 December 2022); Botschaft 2007, pp 1658-1660.

for business operations create liquidity; In contrast, when assets are still needed – and therefore cannot be sold – they can be revaluated according to Art. 670 CO (Art. 725c revOR), although the negative net worth, adverse balance, or negative equity is eliminated if the entity does not acquire more liquidity.<sup>221</sup> Although this measure is technically legal and has long been accepted by the standards,<sup>222</sup> it does not serve to stimulate financial recovery.<sup>223</sup> However, by revaluating these assets, hidden reserves can be released when needed, and thus have a stabilizing character.<sup>224</sup> Ultimately, due to a convincing argument by HANDSCHIN, revaluation reserves were not removed from the CO.<sup>225</sup> HANDSCHIN argues that since revaluation is based on liquidation values, there are other options: For example, assets can be sold at their liquidation price after revaluation in order to prevent over-indebtedness due to their undervaluation.<sup>226</sup> This form of undervaluation is a consequence of the mandatory valuation rules, by which the creation of forced hidden reserves is obligatory.<sup>227</sup>

In the recently changed regulation, the norm governing the revaluation of reserves has been moved to where it better fits as a measure of financial recovery.<sup>228</sup> Substantively, the new Art. 725c revCO contains the same rules, and has therefore remained unmodified.<sup>229</sup> However, it was originally proposed to only allow revaluation if the revaluated assets would be sold within the following twelve months.<sup>230</sup> Furthermore, the wording – and thus the scope of application – has been changed to cover not only capital loss but now also over-indebtedness.<sup>231</sup>

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<sup>221</sup> Botschaft 2007, p. 1658.

<sup>222</sup> HANDSCHIN, Rechnungslegung, par. 665.

<sup>223</sup> Botschaft 2007, p. 1658.

<sup>224</sup> HANDSCHIN, Rechnungslegung, par. 665.

<sup>225</sup> Erläuternder Bericht VE-OR 2014, p. 142.

<sup>226</sup> HANDSCHIN, Rechnungslegungsrecht, 1st ed, par. 662 et seqq.

<sup>227</sup> BÖCKLI, Aktienrecht, § 8 par. 891; GLANZMANN, SJZ 108/2012, p. 208.

<sup>228</sup> Art. 725c revCO (Art. 670); cf. Botschaft, 2016, p. 580; this new position provides a better illustration of this norm's relevance to crisis situations, and thus to the conditions concerning capital loss and over-indebtedness that apply to this reserve, ZK-BÜRGI, Art. 670, par. 27.

<sup>229</sup> Botschaft 2016, p. 524.

<sup>230</sup> Cf. draft 2016. HANDSCHIN, Rechnungslegung, par. 662. Ultimately, this was not integrated in the revised law, see Art. 725c revCO.

<sup>231</sup> Art. 670 par. 1 CO versus Art. 525c par. 1 revCO. The former law (means: still in force until 31 December 2022) only allowed for a revaluation in cases of capital loss.

(b) *Comparison with the Standards*

- 72 This option of reporting the fair value exists in the Swiss<sup>232</sup> and International<sup>233</sup> In the Standards, fair value is understood as the current value, which can be measured in one of three ways: as the current cost,<sup>234</sup> as the fair value minus selling costs (also known as the net selling price),<sup>235</sup> or as the value-in-use.<sup>236</sup> The IFRS defines fair value as the price of selling an asset in an orderly transaction between market participants at the valuation date.<sup>237</sup>
- 73 In 2005, the IASB started a fair value measurement project, the results of which came into force in 2013.<sup>238</sup> Unlike in the CO,<sup>239</sup> according to these rules an entity may choose the cost model<sup>240</sup> or the revaluation model<sup>241</sup> as its accounting policy. This chosen model should then be applied to its entire asset class, including its whole plant (factory) and all of its equipment.<sup>242</sup> Revaluations may be made with sufficient regularity to ensure that the carrying value does not differ materially from the fair value.<sup>243</sup> In the CO, in contrast, revaluations are not generally allowed: land, building or equity participations may be revaluated only in crisis situations such as over-indebtedness<sup>244</sup>.<sup>245</sup> However, while over-indebtedness can be defined according to the CO, it is not yet the case that due equity may be valued higher according to the recognised standards ac-

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<sup>232</sup> Swiss GAAP FER.

<sup>233</sup> IFRS.

<sup>234</sup> IFRS Framework Paragraph 4.55 (b).

<sup>235</sup> IFRS Framework Paragraph 4.55 (c).

<sup>236</sup> IFRS Framework Paragraph 4.55 (d).

<sup>237</sup> IFRS 13.

<sup>238</sup> <https://www.iasplus.com/de/standards/ifrs/ifrs13> (last accessed: 15/01/2021).

<sup>239</sup> In the CO, the production and acquisitions cost models are predominant. HÜTTICHE, veb.ch Praxiskommentar, Art. 960a, par. 118; HWP, p. 7.

<sup>240</sup> IAS 16.30.

<sup>241</sup> IAS 16.31.

<sup>242</sup> IAS 16.29.

<sup>243</sup> IAS 16.31 in fine. According to this model, this will result in a lowering of the value of the hidden reserves or the elimination of the hidden reserves altogether.

<sup>244</sup> Art. 725 par. 2 CO; see Art. 725b revCO.

<sup>245</sup> Furthermore, the revaluation model is also allowed for assets with a stock exchange price or and another observable market price in an active market according to Art. 960b par. 1 CO.



ording than to the CO.<sup>246</sup> Nevertheless, over-indebtedness resulting from equity that has been valued according to the standards may still be accepted as over-indebtedness, as per Art. 725 par. 2 CO (Art. 725b revCO).<sup>247</sup>

According to the CO as well as to the standards, revaluation above the acquisition value generally has an impact on the profit and loss account and causes a revaluation reserve to be created at the corresponding value.<sup>248</sup> This increase should be recognised in the profit and loss account when it causes a corresponding decrease in the value of the same asset in the profit and loss account.<sup>249</sup> Hence, declaring a revaluation without any impact on profit or loss and – and thereby dissolving the forced hidden reserves – is more transparent than undertaking no reporting at all.

Furthermore, due to its lack of impact on the profit and loss account, the revaluated amount is not allowed to be distributed in the form of dividends, therefore making the revaluations prudent.<sup>250</sup> In a similar manner as outlined in the IFRS,<sup>251</sup> revaluations should be made with sufficient regularity so that the changes can be recognised in the revaluation reserves, and thus decrease the value of the hidden reserves.<sup>252</sup>

### (c) *Rules de lege lata*

#### (i) *Creation*

The creation of a revaluation reserve does not lead to a reduction in the distributable profit; as such, since it is thus neutral to the profit and loss account,<sup>253</sup> the creation of a revaluation reserve cannot be subject to abuse. The

<sup>246</sup> AB 2010 par. 1905; CHK Rechnungslegungsrecht-LIPP, Art. 962 par. 8; ZIHLER, ST 2011a, p. 44.

<sup>247</sup> WIRZ, par. 244 et seqq.

<sup>248</sup> GRÜNBERGER, p. 53; HANDSCHIN, Rechnungslegungsrecht par. 667. The terminology in the IFRS is different: revaluation reserves are termed a revaluation surplus. See IAS 16 par. 39 or 40.

<sup>249</sup> IAS 16 par. 39; SWISS GAAP FER 18 par. 13. A gain or loss arising from a change in the fair value of investment property must also be recognised in the profit and loss account for the period in which it occurs. IAS 40 par. 35.

<sup>250</sup> Cf. VIONNET-RIEDERER, par. 343.

<sup>251</sup> IAS 16.31 in fine.

<sup>252</sup> Cf. SIMON, par. 104; cf. HANDSCHIN, Rechnungslegung par. 669 et seqq.

<sup>253</sup> ZK-BÜRGI, Art. 670, par. 5; Cf. HANDSCHIN, Rechnungslegung, par. 659.

revalued amount is consequently frozen or blocked.<sup>254</sup> This means that the revalued amount is not permitted to be offset against the accumulated losses on the balance sheet.<sup>255</sup>

- 77 One option for creating revaluations reserves is through the profit and loss account: this involves disclosing the revalued amount as income and the newly created revaluation reserves as expenses.<sup>256</sup> Moreover, the revalued amount may also be an alternative declared on the balance sheet: This entails elevating the value of an asset and creating a revaluation reserve at the corresponding value.<sup>257</sup> Furthermore, potential use of the revaluation amount is limited, since Art. 670 par. 1 CO (Art. 725c par. 1 revCO) stipulates that a revaluation may only be made “in order to rectify the negative net worth”, a restriction (see below) which also provides no opportunity for abuse.<sup>258</sup> For revaluation, both Art. 725c revCO and Art. 670 CO rely on the new real value. Thus, a revaluation in order to rectify a capital loss is possible if the revaluation is done in rectifying the corresponding amount. Additionally, the revaluation is permitted only where a licensed auditor issues written confirmation for the attention of the general meeting that the revaluation complies with the relevant statutory provisions.<sup>259</sup>
- 78 In order to define the value of the revaluation reserves or the corresponding revaluation amount – namely, the difference between the carrying or book value and the fair value – a valuation method must be selected.<sup>260</sup> Valuation must be performed with sufficient prudence, especially in the case of equity participations when valuating entities. In unlisted companies limited by shares, only their value in use – namely, their share of the corporate value – is declared,<sup>261</sup> a process which falls under the competence of the board of directors.<sup>262</sup> As there are no rules in relation to the full exhaustion, either a partial

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<sup>254</sup> HWP, p. 304; BOEMLE/LUTZ, 392; CHK Rechnungslegungsrecht-LIPP, Art. 959a par. 54 et seq.

<sup>255</sup> BÖCKLI, Revisionsstelle und Abschlussprüfung, § 8 par. 318 et seqq.

<sup>256</sup> BSK II-NEUHAUS/BALKANYI, par. 4. According to BÖCKLI, the revaluation should be listed as an extraordinary income. BÖCKLI, Revisionsstelle und Abschlussprüfung, § 8 par. 765.

<sup>257</sup> HWP, p. 304.

<sup>258</sup> ZK-BÜRGI, par. 14.

<sup>259</sup> Art. 725 par. 2 revCO (Art. 670 par. 2 CO).

<sup>260</sup> Botschaft 2016, 894.

<sup>261</sup> HWP, p. 303; BÖCKLI, Rechnungslegungsrecht par. 486.

<sup>262</sup> Cf. DEKKER, FS Forstmoser, p. 103; BÖCKLI, Revisionsstelle und Abschlussprüfung, § 5 par. 794; see possible variations in HWP, p. 304.

revaluation or a maximum revaluation to fair value is possible.<sup>263</sup> This competence to decide whether or not to revalue or appreciate assets gives the board of directors the scope to choose between filing for bankruptcy immediately or postponing this process.<sup>264</sup> Finally, as shown above,<sup>265</sup> revaluation itself is permitted only when a licensed auditor issues written confirmation to the general assembly that the revaluation complies with the relevant statutory provisions.<sup>266</sup>

### (ii) Dissolution

Dissolution through write-backs is only possible by means of conversion into share capital, a fresh write-down, or disposal of the revalued assets.<sup>267</sup> Conversion into share capital denotes a free capital increase in which the revaluation reserves may be used and thus dissolved.<sup>268</sup> Furthermore, by selling the revalued assets, their value is realised while any protection as well as corresponding obligations to create reserves become completely void.<sup>269</sup> In the new Paragraph 3 of the new Art. 725c revCO, the recently revised legislation explicitly mentions these possibilities,<sup>270</sup> which were previously only mentioned in the doctrine.<sup>271</sup>

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### (iii) Disclosure

According to Art. 959c par. 1 no. 2 CO, the mandatory disclosure of revaluations as revaluation reserves results in an additional minimum structure rule for the relevant equity<sup>272</sup> as well as an extension of the rules on disclosure of information, breakdowns and explanations in the notes relating to items on

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<sup>263</sup> BÖCKLI, Revisionsstelle und Abschlussprüfung, § 15 par. 794, BSK II-NEUHAUS/BALKANYI, Art. 670 par. 10 et seqq.

<sup>264</sup> HANDSCHIN, Rechnungslegung, par. 34.

<sup>265</sup> See [Paragraph 68](#) et seqq for more on revaluation in crisis situations.

<sup>266</sup> Art. 525c par. 2 CO (Art. 670 par. 2 CO).

<sup>267</sup> Art. 617b CO, Participation capital is explicitly mentioned in the revised law. Botschaft 2016, p. 581.

<sup>268</sup> BSK II-NEUHAUS/BALKANYI, Art. 671b, par. 7.

<sup>269</sup> BSK II-NEUHAUS/BALKANYI, Art. 671b, par. 9; BÖCKLI, Revisionsstelle und Abschlussprüfung, § par. 320.

<sup>270</sup> Cf. Botschaft 2016, p. 580 et seq.

<sup>271</sup> HANDSCHIN, Rechnungslegungsrecht, par. 823.

<sup>272</sup> Art. 959a par. 2 no. 3 CO (Art. 959a par. 2 no. 3 revCO) and Art. 958c par. 1 no. 4 CO.

the balance sheet and in the profit and loss account.<sup>273</sup> Although the current minimum structure of equity is no longer mentioned in Art. 959a par. 2 no. 3 CO, a separate disclosure is mandatory in my opinion, recommended by the HWP,<sup>274</sup> and explicitly stated in the ancient Art. 670 par. 1 in fine CO as well as in the actual law Art. 725c par. 1 in fine revCO.<sup>275</sup> Revaluation reserves should be listed as separate sub-items within the retained earnings reserves.<sup>276</sup>

(d) *Rules de lege ferenda*

81 The solutions offered by the CO and the IFRS<sup>277</sup> both have their advantages<sup>278</sup> and disadvantages.<sup>279</sup> As a result, HANDSCHIN has proposed extending de lege ferenda the option of revaluing to fair value in combination with a mandatory formation of revaluation reserves.<sup>280</sup> The creation of revaluation reserves counts as expenditure, which leads to a gain through compensation, given that revaluation is neutral and not recognised in the profit and loss account.<sup>281</sup> The same rules apply to revaluation reserves as to hidden reserves: only when an asset is sold, a gain is realised.<sup>282</sup> As such, revaluation and the corresponding creation of revaluation reserves is a more transparent option.

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<sup>273</sup> BSK II-NEUHAUS/BALKANYI, Art. 670 par. 13 and 16. Disclosure in the notes was already mandatory before the notion of revaluation and its corresponding mechanisms were introduced into the CO, Botschaft 1983, p. 894.

<sup>274</sup> HWP, p. 304.

<sup>275</sup> See also Botschaft 2016, p. 580.

<sup>276</sup> See also Botschaft 2016, p. 580. See [Paragraph 125](#) et seqq on retained earnings reserves.

<sup>277</sup> As revaluation may occur without impacting profit or loss, the risk of abuse of these rules is minimised. However, revaluations that affect the profit and loss account are not prohibited; see IAS 40.35 on investment property. HANDSCHIN, Rechnungslegung, par. 670.

<sup>278</sup> Opportunities for excessive revaluations are limited due to the restrictions on the formation of revaluation reserves. The OR is therefore prudent by allowing no space for misuse. HANDSCHIN, Rechnungslegung, par. 669 and 670.

<sup>279</sup> The valuation rules are opaque and can lead to the formation of hidden reserves. HANDSCHIN, Rechnungslegung, par. 670.

<sup>280</sup> HANDSCHIN, Rechnungslegung, par. 652 et seq. and 699 et seqq. This option involves a margin of discretion weakening the prudence of both principles, as it is in the reporters' discretion to be prudent and true.

<sup>281</sup> *Ibid.*, par. 666 et seqq. A situation in which an immediate dissolution of hidden reserves is combined with the creation of a new valuation reserve differs in this regard. This would not constitute a simple revaluation, but one which affects the profit and loss account. See HANDSCHIN, Rechnungslegung, par. 736.

<sup>282</sup> HANDSCHIN, Rechnungslegung, par. 671.

Furthermore, tax law should be adapted to promote revaluation reserves as a prudent and transparent instrument.<sup>283</sup> Even though corporate law classifies the revaluation process as having no impact on profit or loss, tax law contravenes the authoritative principle by not allowing this.<sup>284</sup> As the formation of revaluation reserves does not count as business-related expenditure<sup>285</sup> and revaluations that have no impact on profit and loss result in a taxable gain, an entity is more likely to choose to form hidden reserves than revaluation reserves.<sup>286</sup> This may also be explained by the fact that revaluation, as a passive correction, is not classified as a value adjustment but reported in the equity. For this reason, tax law classifies it as a false revaluation that counts towards profit or loss.<sup>287</sup>

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Hence, by not implementing the authoritative principle but instead allowing for the offsetting of losses, fair taxation that reflects an entity's true financial capacity is impeded.<sup>288</sup> Because the current solution lacks any such adaptation, it promotes hidden reserves rather than revaluation reserves.

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### (e) *Position in the CO*

Since its introduction in 1991, there has been significant controversy surrounding the possible removal of revaluation reserves from the CO, despite the fact that they represent a more modern type of reserve in comparison to the other categories of reserves in the CO, which historically have been especially important in times of war. The concept of revaluation reserves has been influenced by the concept of fair value in the international standards and is thus a more modern concept. Furthermore, the inclusion of revaluation reserves in the 2020 revision may also be seen as a move towards fair value valuation.

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The systematic position of revaluation reserves in the CO will change with the revised law. This placement is unusual for an accounting reserve: The revaluation reserves will remain in the section regulating companies limited by shares in crisis situations, and thus not alongside the other accounting reserves, which are listed under the accounting rules in Art. 957 CO. Revaluation re-

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<sup>283</sup> Ibid., par. 672.

<sup>284</sup> Independent of which form of disclosure is chosen; see HWP, p. 304 et seq; Art. 58 par. 1 lit. c DBG.

<sup>285</sup> Art. 58 Abs. 1 lit. b DBG; SCHALCHER, pp 109.

<sup>286</sup> HANDSCHIN, Rechnungslegung, par. 672.

<sup>287</sup> BAUEN, pp 176 and 193.

<sup>288</sup> BSK DBG-BRÜLISAUER/MÜHLEMANN, Art. 58 DBG, par. 432.

erves have until now been placed among the legal reserves. Although this meant that all reserves were positioned together, it created a degree of confusion, since the other types of reserves are all legal reserves, the creation of which falls under the competence of the general assembly. In this crucial aspect of competences, the revised law will provide clarity by placing revaluation reserves among the measures for companies limited by shares in crisis situations, which – like revaluation reserves – also fall under the competence of the board of directors.

## (2) *Fluctuation Reserves*

- 86 Fluctuation reserves<sup>289</sup> are a type of revaluation reserve<sup>290</sup> that is not only applicable to land, building and equity participations but rather has an unlimited scope of application.<sup>291</sup> While revaluation reserves are tied to the above-described crisis situations, fluctuation reserves may be formed on most other occasions.<sup>292</sup> According to Art. 960a par. 2 CO, fluctuation reserves represent an exception to acquisition or manufacturing costs as well as a breach of the realisation principle.<sup>293</sup>

### (a) *Historical Background and Terminology*

- 87 The old CO already had an exceptional<sup>294</sup> or special<sup>295</sup> rule that applied only to securities, foreign exchange and money market investments in current assets.<sup>296</sup> This regulation was already well known in relation to insurance companies or provident institutions, but it proved equally appropriate for entities that sought to achieve more transparency by listing their stock market price as well as for entities seeking to keep negative consequences under control through the formation of fluctuation reserves.<sup>297</sup>

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<sup>289</sup> Art. 960b par. 2 CO.

<sup>290</sup> HANDSCHIN, Rechnungslegung, par. 615 and 823.

<sup>291</sup> See table in HÜTTSCHE, veb.ch Kommentar, Art. 960b par. 40.

<sup>292</sup> Ibid.

<sup>293</sup> BSK OR-NEUHAUS/HAAG, Art. 960b par. 1. This valuation model is an exception in the CO. Cf. HÜTTSCHE, veb.ch Kommentar, 960b par. 42.

<sup>294</sup> BSK OR-NEUHAUS/INAUEN, Art. 667 par. 2.

<sup>295</sup> BÖCKLI, Aktienrecht, § 8 par. 777.

<sup>296</sup> Cf. Art. 667 par. 1 CO (deleted in 2013); HÜTTSCHE, veb.ch Kommentar, Art. 960b par. 7.

<sup>297</sup> Botschaft 2008, p. 1713.

This option was then extended to all assets with a stock market price<sup>298</sup> or an observable market price.<sup>299</sup> This new wording could have led to confusion, but in light of its history<sup>300</sup> it is clear that the new law's phrase "assets with a stock exchange price" signified the intention of the legislation to extend the application of Art. 960b CO to other values determined outside the stock exchange.<sup>301</sup> As such, the phrase "assets with a stock exchange price or another observable market price in an active market" denotes securities, precious metals, and commodities that are regularly traded on the stock exchange or over-the-counter (OTC) markets.<sup>302</sup>

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### (b) *Voluntary Nature*

A different valuation model for subsequent valuations may be selected for assets with a stock exchange price or another observable market price in an active market. An entity may choose to revalue its acquisition or manufacturing costs<sup>303</sup> or to value these at the same price as per the date of the balance sheet, even if this price exceeds the nominal value or the acquisition value.<sup>304</sup>

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In the case of assets that are valued at the stock exchange price or at the market price as per the date of the balance sheet, the entity has the right to make a further report: a value adjustment to be charged to the profit and loss ac-

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<sup>298</sup> Draft CO 2007; Botschaft Aktienrecht 2007, p. 1712.

<sup>299</sup> Protokoll RK-S 18-19/8/2011, pp 1 et seqq; AB 2011 pp 719 et seqq. Further regulations were not proposed; it was not the aim of the legislation to adopt the understanding of the concept outlined in IAS 16.31 and 31. HÜTTICHE, veb.ch Kommentar, 960b par. 42; HANDSCHIN, Rechnungslegung par. 613a. According to another opinion, the legislation intended to extend it; see more in SUTER/TEITLER- FEINBERG, ST 11/2012, p. 840.

<sup>300</sup> KRAMER, p. 122; BGE 100 II 52 consideration 2.a.

<sup>301</sup> AB 2099 p. 1197; AB 2010 par. 1380; AB 2011 pp 259-260; AB 2011 par. 878-879; AB 2011, pp 719-720.

<sup>302</sup> BSK II-NEUHAUS/INAUEN, Art. 667 par. 6. In Art. 959a par. 1 no. 1 lit. a CO, they are described as current assets with a stock exchange price. See HANDSCHIN, Rechnungslegung, par. 613a.

<sup>303</sup> Art. 960a par. 2 CO.

<sup>304</sup> Art. 960b par. 2 CO; BSK II-NEUHAUS/HAAG, Art. 960b par. 14. According to Art. 960b par. 1 CO, assets must be valued no higher than their acquisition or manufacturing costs for the first disclosure.

count may be made in order to account for fluctuations in the price development.<sup>305</sup> As a voluntary decision within another voluntary choice,<sup>306</sup> making use of a fluctuation reserve is completely optional.<sup>307</sup>

(c) *Formation and Dissolution*

- 91 As explicitly mentioned in Art. 960b par. 2 CO, value adjustments must be charged to the profit and loss account, and thus clearly affect the profit and loss account.<sup>308</sup> In short, an entity's choice to form a fluctuation reserve has a compensating effect that ensures that there is no overall impact on the profit and loss account.<sup>309</sup> The creation of a fluctuation reserve is thus at the discretion of the entity and is consequently not recognised in the profit and loss account. This variation is favoured by the doctrine<sup>310</sup> as the most prudent method since it complies with the international standard<sup>311, 312</sup>.
- 92 The CO defines this item as a value adjustment. Therefore, according to Art. 960a par. 3 CO, it may not be reported as a financial liability.<sup>313</sup> However, according to BÖCKLI, this special item does not represent a genuine value adjustment in the form outlined in Art. 960a par. 3 CO because it does not eliminate any specific overvaluation; instead, it should be classified as a "corridor" for future fluctuations in the price development.<sup>314</sup> Further valuation adjustments are only permitted if they would result in both the acquisition value and the lower market value being undercut.<sup>315</sup>

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<sup>305</sup> Art. 960b par. 2 CO; BSK II-NEUHAUS/HAAG, Art. 960b par. 19.

<sup>306</sup> BÖCKLI, Rechnungslegung, par. 386: Translated from German: *Wahlrecht im Wahlrecht*.

<sup>307</sup> HWP, p. 205.

<sup>308</sup> HWP, p. 204.

<sup>309</sup> HÜTTICHE, veb.ch Kommentar, Art. 960b par. 40; HANDSCHIN, Rechnungslegung, par. 615; see the examples in par. 616.

<sup>310</sup> HWP, p. 62; HANDSCHIN, Rechnungslegung, par. 656; CHK-Rechnungslegungsrecht-LIPP, Art. 960b par. 35.

<sup>311</sup> IFRS 9 and IFRS 13. See for the comparison also HÜTTICHE, veb.ch, Kommentar, Art. 960b par. 42.

<sup>312</sup> VIONNET-RIEDERER, par. 316 and 387.

<sup>313</sup> Wording in Art. 960b par. 2 CO; also Botschaft 2007, 1713; BÖCKLI, Rechnungslegung, par. 386. For a different opinion, see HANDSCHIN, Rechnungslegung par. 615 and 616 with examples.

<sup>314</sup> BÖCKLI, Rechnungslegung, par. 386. Similarly, KLEINBOLD, ST 11/2012, p. 872.

<sup>315</sup> Art. 960b par. 2 CO.



Revaluation reserves and fluctuation reserves alike are dissolved when a corresponding asset is sold or devalued.<sup>316</sup> Unlike revaluation reserves, however, fluctuation reserves may be distributed and thus do not constitute protected or frozen equity.<sup>317</sup>

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#### (d) Disclosure

According to some authors, since the legislation describes fluctuation reserves as adjustments, it might appear that it is mandatory to report them among the assets.<sup>318</sup> However, since they are classified as reserves and fall under the same category as revaluation reserves, it is equally legitimate to report fluctuation reserves as financial liabilities.<sup>319</sup> While the CO provides a choice between showing the total value of the fluctuation reserves on the balance sheet or in the notes to the accounts, they must be listed.<sup>320</sup>

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It is unconvincing to argue that the term “value adjustment”<sup>321</sup> and the implications thereof<sup>322</sup> prohibit the reporting of fluctuation reserves as financial liabilities under the reserves<sup>323</sup> or as provisions,<sup>324</sup> and instead require that they be reported among the assets as negative assets.<sup>325</sup> In fact, BÖCKLI correctly describes how fluctuation reserves effectively become financial liabilities at the value of their corresponding assets.<sup>326</sup>

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<sup>316</sup> HANDSCHIN, Rechnungslegung, par. 825a.

<sup>317</sup> Cf. HANDSCHIN, Rechnungslegung, par. 825a; cf. HÜTTCHE, veb.ch Kommentar, Art. 960b par. 40.

<sup>318</sup> Cf. HWP, p. 205.

<sup>319</sup> Cf. HANDSCHIN, Rechnungslegung, par. 615 and 616.

<sup>320</sup> Art. 960b par. 2 CO; BSK OR-NEUHAUS/HAAG, Art. 960b par. 21.

<sup>321</sup> This term is incorrectly used and not appropriate here; see HANDSCHIN, Rechnungslegung, par. 613a; also HÜTTCHE, veb.ch Kommentar, 960b, par. 9. Similarly, BÖCKLI defines fluctuation reserves as a special item and not a genuine value adjustment.

<sup>322</sup> Like hidden reserves, fluctuation reserves are classified as equity. Prior to their formation, according to BÖCKLI, fluctuation reserves are hidden reserves. BÖCKLI, Rechnungslegung, par. 386.

<sup>323</sup> HANDSCHIN, Rechnungslegung, par. 616.

<sup>324</sup> STERCHI/MATTLE/HELBLING, p. 103.

<sup>325</sup> Fluctuation reserves are listed as value adjustments of the respective assets. According to Art. 960b par. 2 in combination with Art. 960a par. 3 CO, it is not permitted to list fluctuation reserves among the financial liabilities. HWP, p. 205. NEUHAUS and HAAG describe fluctuation reserves as negative assets, BSK OR-NEUHAUS/HAAG, Art. 960b par. 3.

<sup>326</sup> BÖCKLI, Rechnungslegung, par. 386.

- 96 In relation to taxes, fluctuation reserves are founded on business grounds even though their creation is not mandatory.<sup>327</sup> If this were not the case, the goal of the legislation – providing greater transparency via Art. 960b CO – would be rendered moot or would be defeated.<sup>328</sup>

### (3) *Negative Reserves?*

#### (a) *Definition and Terminology*

- 97 According to Art. 959a par. 2 CO, own capital shares – namely, repurchased contributions – must be listed as negative items among the equity.<sup>329</sup> It is not permitted to list the same type of equity twice – in other words, to list under the equity another type of equity when this type has already been listed. As such, the term “negative reserve” is more accurate, especially in relation to the former Art. 659a par. 2 CO.<sup>330</sup> This older norm, which is found under company law rather than accounting law, prescribes that a company must set aside as a “separate reserve” an amount equivalent to the cost of acquiring its own shares.<sup>331</sup> In the corresponding Art. 659a par. 4 revCO, the term “separate reserve” finally falls away. By 2007, however, this term had already been prohibited; as Botschaft made explicit, a previous reserve for own shares (own contributions) was not to be listed as a separate reserve but as a negative item.<sup>332</sup> Generally, the term “negative reserve” may be used; since reserves do not represent a stock or a fund, they do not need to have a positive value as long as they function as negative items among the liabilities,<sup>333</sup> thereby reducing the freely disposable equity due to the capital reduction. However, like in the case of a capital reduction, the balance sheet is thus shortened.<sup>334</sup> By taking a closer look at the reporting rules and at the genuine function of the concept, it should be questioned whether the term “negative reserve” or “negative item” is more accurate, especially since the term “separate reserve” will not be used in the new law.

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<sup>327</sup> HWP, p. 204.

<sup>328</sup> ALTORFER/DUSS/FELBER, ASA 83 2014/2015, p. 529.

<sup>329</sup> See also Art. 659a par. 4 revCO, which contains a reference to Art. 959a par. 2 CO.

<sup>330</sup> ZK-HANDSCHIN, Art. 659–659b, par. 20.

<sup>331</sup> Art. 659a par. 4 revCO; Botschaft 2016, p. 520.

<sup>332</sup> Botschaft 2007, p. 1600.

<sup>333</sup> HANDSCHIN, Rechnungslegung, par. 920a.

<sup>334</sup> Botschaft 2016, p. 520.

*(b) Reporting Rules for Own Equity Instruments**(i) New Reporting Rules: Proscription on Reporting Own Equity Instruments*

An entity or company's repurchasing of its own shares results in capital reduction because capital is spent in exchange for shares.<sup>335</sup> An entity or company's own equity instruments are not classified among its assets or financial liabilities, and consequently cannot be designated as hedging instruments.<sup>336</sup> As such, the true reduction in capital as a result of repayment to the equity providers or investors must be shown.<sup>337</sup> This results in the conclusion that own shares do not have a financial value as well as in the corresponding prohibition on reporting own shares on the balance sheet even though they have a stock market price.<sup>338</sup>

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Own shares can only be reported as assets when they are due to be sold according to a binding contract.<sup>339</sup> Own share instruments have no value in case of insolvency<sup>340</sup>.<sup>341</sup> As outlined in Art. 725 par. 1 CO (Art. 725a par. 1 revCO),<sup>342</sup> the value of any own share instruments related to capital loss (and over-indebtedness) must be consistently subtracted so that the value of the liability substrate is not deflated.<sup>343</sup>

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*(ii) Previous Reporting Rules*

Prior to the 2013 revision, a different understanding of repurchasing own contributions and the reporting thereof prevailed: it was mandatory to report repurchased own shares due to the understanding of own contributions as assets on the balance sheet. As the acquisition of own contributions reduces the

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<sup>335</sup> HANDSCHIN, Rechnungslegung, par. 915.

<sup>336</sup> IAS 39, AG97.

<sup>337</sup> Botschaft 2007, pp 1660, 1706; see also Botschaft 2016, pp 520 et seqq.

<sup>338</sup> HANDSCHIN, Rechnungslegung, par. 912a et seq.

<sup>339</sup> Cf. BÖCKLI, Aktienrecht, § 8 par. 273; ZK-HANDSCHIN, Art. 659-659b, par. 63.

<sup>340</sup> Art. 725 par. 2 CO (Art. 725b revCO).

<sup>341</sup> Cf. BSK OR-LENZ/VON PLANTA, Vorbemerkung zu Art. 659-659b par. 2; BGE 117 II 290 consideration 4 d.aa.

<sup>342</sup> Cf. BÖCKLI, SWZ 5/2017, p. 528 et seqq; GLANZMANN GesKR 4/2017, p. 394 et seqq. The revised law in Art. 725a revCO (Art. 725 par. 1 CO) is stricter in relation to financial measures, since it already applies earlier.

<sup>343</sup> GLANZ, veb.ch Kommentar, Sonderbilanzen nach OR, par. 32.

liability basis, a compensating reserve to the value of the corresponding acquisition price was thus created.<sup>344</sup> However a change of thinking took place, which was based on the Standards, according to which the legal and economical result of repurchasing own shares was “shown better” in the sense that it was made more transparent and additionally the balance sheet gets extended unnecessarily.<sup>345</sup> This entailed changing the new reporting rules to prohibit the reporting of own equity instruments, as explained above in [Paragraph 69 et seq.](#)

(c) *Function*

101 The French wording, in contrast to the German and Italian wording, directly describes the function “en diminution des capitaux propres” instead of naming it item or “Minusposten” or “posta negative”. The function of negative items is to protect equity from illegitimate repayments to investors that would circumvent the limitation rules relating to distributions or pay-outs.<sup>346</sup> The prohibition on pay-outs does not mean that the financial liabilities include a positive amount representing retained earnings that would reduce the value of the reserves.<sup>347</sup> Instead, default reporting or activation results in a negative amount being reported among the financial liabilities, and it is this which constitutes a negative reserve.<sup>348</sup> For example, a company with a profit of 100 CHF cannot distribute this profit unless a negative reserve to the value of – 100 CHF is dissolved; for as long as the negative reserve remains in existence, it must be deducted from the distributable profit.<sup>349</sup>

102 The manner in which this mechanism operates must be scrutinized carefully. How does a negative item or reserve among the equity – originating from a capital reduction resulting from the acquisition of own shares – block distributable profit? Reserves are usually defined by their function of blocking and thus protecting equity. However, in the case of a negative reserve or item, the same result is achieved but by a wholly different mechanism. Since capital reduction itself is responsible for the decreased opportunities for distribution, any reduction in capital will have as an “inherent effect” the lowering of distributable profit. This means that the only function of a negative item is to

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<sup>344</sup> Cf. Botschaft 2007, p. 1660.

<sup>345</sup> Ibid.

<sup>346</sup> GUTSCHE, veb.ch Praxiskommentar, Art. 959a par. 167.

<sup>347</sup> Cf. HANDSCHIN, Rechnungslegung par. 920 et seqq; HWP, p. 243.

<sup>348</sup> Cf. Ibid.

<sup>349</sup> See an example balance sheet in HANDSCHIN, Rechnungslegung, par. 918-919.

compensate for the proscription on reporting the acquisition of own assets. As the function of negative items has now been clarified, it should be questioned in a second step what a negative item achieves. Besides the obvious consequence of a capital reduction effectively lowering the disposable profit, a negative item is employed in the same manner as a positive item in order to generate this blocking effect. Ultimately, a negative item thus achieves the same result as a positive item. When own shares are finally sold, any profit obtained therefrom is not permitted to be counted as disposable profit due to the release of the negative item, a rule which results in a corresponding increase in liabilities. As a result, this should be reconsidered *de lege ferenda*.

(d) *Accurate Solution in the CO?*

The most recent changes were strongly influenced by the Standards, which had already incorporated the concept of a revaluation reserve. However, the CO is generally based on a system of fixed equity capital that serves to ensure capital preservation.<sup>350</sup> The previous method of reporting was more compatible with the CO: Negative items – despite being legally valid and the better solution – come into conflict with the principle of fixed capital with a negative item, and ultimately stand in contradiction to capital preservation. Especially when the minimum capital is – in a theoretical example – undercut by a negative reserve, the new reporting method meets its limits and becomes problematic.<sup>351</sup> This leads to the question of whether the ancient reporting method – the reporting of shares combined with a positive reserve that blocks the distributable profit to the same value – would have been preferable, even at the cost of inflating the balance sheet (and reporting own shares as assets instead of showing a capital reduction). This method has also been abolished because of the above-mentioned legal misconception.

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The question now arises as to how the former, already improved system could be further optimized. From a legal-theoretical perspective, the new method has the advantage that it makes more sense to avoid the creation of a reserve, since own shares are rightly not allowed to be reported.<sup>352</sup> In case a negative reserve is created, it does not operate like a typical reserve by blocking the

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<sup>350</sup> MEYER, TOBIAS, *GesKR 2008/220*, p. 221 with a reference to Cf. *GUHL/DRUEY*, § 66 par. 3.

<sup>351</sup> As the Swiss Code of Obligations still knows a limit. See *ZK-JUNG*, Art. 621, par. 6 et seqq.

<sup>352</sup> Although the new reporting – from a legal perspective – is more correct because own shares have no value in the event of bankruptcy, the former reporting had advantages, such as the disclosure of the amount of own shares. This advantage in particular is a sufficient and convincing reason to maintain the previous method.

disposable profit through reducing the profit carried forward; instead, it blocks the distributable profit indirectly through a capital reduction resulting from not reporting repurchased own assets. As such, this artificial or indirect blockage of disposable profit differs from the typical function of a reserve. Additionally, while the function of other types of reserve is capital preservation, a negative reserve lowers the value of the equity in correspondence to its value of the reserve. In conclusion, the term “negative item” rightly replaced the term “reserve” in the last revision, since “reserve” would have been an inaccurate description of how this instrument functions. Moreover, a negative item is nothing more than a reporting instrument that is necessary for showing that own assets have been repurchased. While this method is deemed incorrect from a legal point of view, it is preferable when considered from a logical-mathematical perspective: It discloses and makes visible the act of purchasing one’s own shares in the exact amount. Disclosure and transparency are discussed in the context of the principles of accounting in [Paragraph 194 et seqq.](#)

### (e) *Sub-Types*

- 105 Although own capital contributions are usually only typical for companies limited by shares,<sup>353</sup> 959a par. 2 CO is applicable to and mandatory for limited liability companies and cooperatives.<sup>354</sup> For all sub-types of negative reserves, the reported value should correspond to the value of the acquisition cost. This amount remains the same when there is no subsequent valuation, regardless of any changes in the market.<sup>355</sup>
- 106 Furthermore, it must be listed as shareholder equity and structured in the required legal form as per Art. 959 par. 7 CO.<sup>356</sup>

### (i) *Own Shares*

- 107 According to Art. 659a par. 4 revCO (Art. 659 par. 2 CO), a limited liability company may acquire its own shares only when freely disposable equity capital is available in the required amount and the combined nominal value of all such

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<sup>353</sup> Namely, when new shares are issued to workers or issued to fulfil share capital plans, protect against takeover attempts, undervalue shares in the market, implement constitutive capital reduction plans or invest excess liquidity, GUTSCHE, veb.ch Praxiskommentar, Art. 959a, par. 166.

<sup>354</sup> GUTSCHE, veb.ch Praxiskommentar, Art. 959a, par. 166.

<sup>355</sup> HWP, p. 244.

<sup>356</sup> GUTSCHE, veb.ch Praxiskommentar, Art. 959a par. 166 and 145 et seqq.

shares does not exceed 10% of the share capital.<sup>357</sup> Hence, a company may use only freely disposable equity capital, profit carried forward, or the free portion of the legal reserves.<sup>358</sup> Participation certificates<sup>359</sup> also count as own shares,<sup>360</sup> but dividend rights certificates do not.<sup>361</sup> These are not issued for contributions<sup>362</sup> and therefore cannot be classified as a reimbursement of paid-in capital.<sup>363</sup> As a consequence of the acquisition of its own shares, a company has the obligation to create a negative reserve to the corresponding value of these shares. This negative reserve can be created not only by the issuing company itself purchasing its own shares directly,<sup>364</sup> but also indirectly through a purchase by a subsidiary in which the company holds a majority interest.<sup>365</sup>

A negative reserve decreases in value in a manner that corresponds to the reduction of the nominal value of the share capital when shares are eliminated through a capital deduction.<sup>366</sup> Negative reserves also change in value when additional shares are purchased or when own shares are sold; any resulting difference in value is allocated to the capital reserves.<sup>367</sup>

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## (ii) *Own Capital Contributions*

Although, as per Art. 783 par. 4 CO, the relevant regulations on the acquisition of own shares by a company limited by shares also apply to the acquisition of own capital contributions by a limited liability company, there are some peculiarities in relation to the latter. First, a decision to purchase own capital con-

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<sup>357</sup> Art. 659 revCO.

<sup>358</sup> HANDSCHIN, Rechnungslegungsrecht, par. 921. See [Paragraph 113](#) for more on legal reserves.

<sup>359</sup> Art. 656a OR et seqq.

<sup>360</sup> HWP, p. 241.

<sup>361</sup> Art. 657 CO.

<sup>362</sup> Art. 657 par. 3 CO; ZK-HANDSCHIN, Art. 659-659b; Botschaft 2002, p. 3183.

<sup>363</sup> HWP, p. 242. For a different opinion, see: ZK-HANDSCHIN, Art. 659-659 par. 1; BÖCKLI, Aktienrecht, § 4 par. 355.

<sup>364</sup> GUTSCHE, veb.ch Praxiskommentar, Art. 959a, par. 167.

<sup>365</sup> Art. 659b par. 2 CO. According to par. 3, the obligation to form a reserve rests with the company that holds the majority interest; cf. the transparent and clear rule in the new Art. 659 par. 2 revCO.

<sup>366</sup> HANDSCHIN, Rechnungslegung, par. 924; GUTSCHE, veb.ch Praxiskommentar, Art. 959a par. 173.

<sup>367</sup> HANDSCHIN, Rechnungslegung, par. 923 et seqq. However, changes in the market value of own shares have no impact on the balance sheet.

tributions generally falls under the competence of the members' general meeting;<sup>368</sup> however, it may authorise the company's managing director to acquire own capital contributions.<sup>369</sup> Hence, acquisitions constitute a transfer of capital contributions, as per Art. 785 CO. Consent to the assignment of capital contributions must thus be passed by a two-thirds majority of the members present and an absolute majority of the entire nominal capital in respect of which an exercising of the right to vote will be required.<sup>370</sup>

- 110 Another peculiarity that applies to limited liability companies relates to additional financial or material contributions. In case capital contributions are tied to an obligation to make additional financial or material contributions, these must be cancelled before acquisition.<sup>371</sup> Such an obligation would be illogical because it would lead to a company acquiring capital contributions that are tied to additional financial or material contributions,<sup>372</sup> and in so doing becoming indebted to itself.<sup>373</sup> However, a company could acquire own capital contributions as credit, and thus repay additional financial contributions.<sup>374</sup>
- 111 Finally, the maximum acquisition value of 35% in cases where capital contributions are acquired in connection with a restriction on transfer or the departure or exclusion of a member of a limited liability company differs from the stipulated limit of 20% for companies limited by shares.<sup>375</sup> A person-centred structure requires a higher limit in order to facilitate the withdrawal from the company of a partner that holds at least one-third of the capital contributions.<sup>376</sup>
- 112 However, from the perspective of capital protection, the limit of 35% is very high; hence, in order to prevent risk to creditors,<sup>377</sup> capital contributions in excess of 10% of the nominal capital must be sold within two years or cancelled by means of a reduction of capital.<sup>378</sup>

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<sup>368</sup> Cf. Art. 804 par. 2 no. 11 in fine CO; BSK II-LENZ/PLANTA, Art. 783 par. 8.

<sup>369</sup> Cf. Art. 804 par. 2 no. 11 CO; CR-CHAPPUIS/JACCARD, Art. 804, par. 15 et seqq.

<sup>370</sup> Resolution of the members' general meeting, as per Art. 808b par. 1 no. 4 CO.

<sup>371</sup> Art. 783 par. 3 CO.

<sup>372</sup> Botschaft GmbH 2002, p. 3183.

<sup>373</sup> HANDSCHIN/TRUNIGER, § 9 par. 45 et seqq, 235; CR-CHAPPUIS/JACCARD, Art. 783, par. 31.

<sup>374</sup> ZH-VON STEIGER, par. 783, par. 5; BSK II-LENZ/PLANTA Art. 783 par. 7.

<sup>375</sup> Art. 783 par. 2 CO versus Art. 659 par. 2 CO; HWP, p. 242.

<sup>376</sup> BSK II-LENZ/PLANTA, Art. 783 par. 1 et seqq; Botschaft GmbH 2002, p. 3183.

<sup>377</sup> Botschaft, GmbH 2002, p. 3183.

<sup>378</sup> Art. 783 par. 2 in fine CO.



## 2.1.2. Legal Reserves

### (1) *Definition and Function*

Statutory legal reserves differ from statutory accounting reserves, especially in that they may be dissolved at the discretion of the company if they reach a certain value.<sup>379</sup> Like accounting reserves, the creation of statutory reserves is legally mandatory.<sup>380</sup> Legal reserves are debt items that have no corresponding real value from which an investment could be financed.<sup>381</sup> A portion of the reserve, which is not allowed to exceed one-half of the share capital, may be frozen in order to prevent distribution and thus protect the capital, while the rest functions as a financial buffer to absorb losses.<sup>382</sup> 113

Legal reserves apply to companies limited by shares,<sup>383</sup> limited liability companies<sup>384</sup> and cooperatives.<sup>385</sup> The section below explores how statutory reserves are used by different types of companies. The Code of Obligations has only included legal reserves since 1936; currently, legal reserves are termed general statutory reserves in Art. 671 CO et seqq (Art. 671 revCO et seqq).<sup>386</sup> As their earlier name indicates and as will be discussed below, legal reserves are mandatory under the law. 114

### (2) *Creation*

#### (a) *Competence*

The creation of statutory reserves above a limit of 20% is not at the discretion of a company.<sup>387</sup> As long as the 20% limit is not reached, the first allocation is mandatory.<sup>388</sup> The general assembly has no discretion in this matter, but chal- 115

<sup>379</sup> HANDSCHIN, Rechnungslegung par. 826.

<sup>380</sup> Ibid., par. 826.

<sup>381</sup> BSK II-NEUHAUS/BALKANYI, Art. 671 par. 3. In particular, the term “reserve” fund as a “stock” is incorrect. ZH-BÜRGI, par. 671, par. 16, Botschaft Rechnungslegung 2008, p. 1659.

<sup>382</sup> BÖCKLI, Rechnungslegung, par. 508a.

<sup>383</sup> Art. 671 et seqq CO.

<sup>384</sup> Art. 801 CO. See further details in [Paragraph 316 et seqq](#) and [322](#).

<sup>385</sup> Art. 860 CO. See further details in [Paragraph 345 et seqq](#) and [358](#).

<sup>386</sup> BÖCKLI, Rechnungslegung, par. 508; CO 1936; CO 1991.

<sup>387</sup> ZH-BÜRGI, Art. 671 par. 45.

<sup>388</sup> BSK OR II-NEUHAUS/BALKANYI, Art. 671 par. 9.

allenges may be brought against such a resolution.<sup>389</sup> Not even the general assembly has the authority to decide against this mandatory first allocation, and any decision that violates this allocation requirement is challengeable.<sup>390</sup> Regarding the competence, the revised law will bring no changes. Only the Art. 670 CO on revaluation reserves an article before Art. 671 revCO is moved. At first glance, the systematic proximity of accounting reserves in the actual Art. 670 CO (Art. 725c revCO) to legal reserves in Art. 671 and 672 CO (Art. 671 – 673 revCO) could create confusion, because the board is competent for the former and the general assembly for the latter. Only in Art. 674 CO is it explicitly stated that the creation of further reserves other than those by means of the articles of association or by resolution fall under the competence of the general assembly. This question will be discussed in [Paragraph 294](#). The Botschaft does not mention any change or clarification regarding the competence.

(b) *Actual Regulations*

(i) *Allocations*

- 116 Legal reserves are created through two possible mandatory allocations. If the requirement of 5% of the annual profit is met,<sup>391</sup> this amount must be allocated to the general reserve<sup>392</sup> annually until the legal reserves reach the threshold of 20% of the paid-up share capital.<sup>393</sup> Companies have no discretion in this regard, but no allocation is made in case of very little annual profit.<sup>394</sup> Offsetting with the annual profit occurs when a loss is recorded on the balance sheet<sup>395 396</sup>. According to Art. 671 par. 4 CO, holding companies are exempt from this initial allocation.

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<sup>389</sup> Cf. Art. 706 CO; ZK-BÜRGI, 671 par. 82.

<sup>390</sup> Ibid.

<sup>391</sup> See more on the profit and loss account in CO 959b par. 2 no. 11 and par. 3 no. 8.

<sup>392</sup> HWP, pp 232 et seqq; BÖCKLI, Revisionsstelle und Abschlussprüfung, § 8 par. 308, ZK-BÜRGI, Art. 671 par. 29.

<sup>393</sup> BSK II-NEUHAUS/BALKANYI, Art. 671 par. 6.

<sup>394</sup> HWP, p. 232 et seqq.

<sup>395</sup> Accumulated losses, more in BÖCKLI, Rechnungslegung, par. 522.

<sup>396</sup> Ibid.

In addition to this first allocation, a second allocation occurs if a company distributes dividends to the value of more than 5% of the annual profit: Then of 10% of the amounts distributed as the share in the profit above and beyond (exceeding) payment of a dividend of the just mentioned 5% of the annual profit is allocated to the legal reserves.<sup>397</sup> 117

For example, for a company with CHF 100,000 paid-up share capital and an annual profit of CHF 10,000, dividends up to the value of CHF 7,000 can be distributed. The first allocation to the legal reserves would amount to 5% of the annual profit of CHF 10,000 (CHF 500); the second allocation would be 10% of CHF 2,000 (CHF 200).<sup>398</sup> While the first allocation is limited to no more than 20% of the share capital, the second allocation has no upper limit.<sup>399</sup> The first allocation is determined by the annual profit, the second by the value of the distributed profit shares or dividends.<sup>400</sup> 118

### (ii) *Characteristics of Allocations*

Legal reserves are derived from annual profit,<sup>401</sup> from capital contributions as additional paid-in capital, or from agio, namely the surplus above the nominal value after the issuance of shares or participation capital<sup>402 403</sup>. Finally, according to Art. 681 CO, any profits that arise from forfeiture must be allocated to the legal reserves.<sup>404</sup> Following this general description of unrecoverable contributions or non-returnable contributions, it is important to define their specific characteristics and answer the question of whether the same rules are applied in relation to the creation and, in particular, the dissolution<sup>405</sup> and use of both subtypes. Except in the case of agio or additional paid-in capital, allocations are classified as earned profit and not as paid-in capital.<sup>406</sup> The former accounting rules also differentiate between allocations in terms of their characteristics and origin; new company legislation has been adapted to these recent means of differentiation. 119

<sup>397</sup> Art. 671 par. 2 no. 3; HWP, p. 232 et seqq.

<sup>398</sup> HANDSCHIN, Rechnungslegung, par. 829.

<sup>399</sup> BSK II-NEUHAUS/BALKANYI, Art. 671 par. 14.

<sup>400</sup> BÖCKLI, Revisionsstelle und Abschlussprüfung, § 8 par. 308; SCHUCANY, par. 7.

<sup>401</sup> Art. 671 par. 1 CO.

<sup>402</sup> Art. 656a Abs. 2 CO.

<sup>403</sup> Art. 671, Abs. 2 no. 1 CO; HWP, p. 232 et seqq; also BÖCKLI, Rechnungslegung par. 508.

<sup>404</sup> Art. 671 par. 2 no. 1 CO; HWP, p. 226.

<sup>405</sup> See [Paragraph 131](#).

<sup>406</sup> BSK II-VOGT, Art. 680, par. 20.

### (3) *Subdivisions*

120 The recently amended accounting legislation subdivides legal reserves into two subtypes<sup>407</sup> – retained earnings reserves and capital reserves – according to their characteristics, the origins of their paid-in surplus and retained surplus, or visible earnings on the balance sheet.<sup>408</sup> Nevertheless, Parliament<sup>409</sup> rejected the Federal Council’s proposed rules for differentiating between these two kinds of reserves on the basis of distribution, with the result that currently the only means of differentiating between them is by their new separate visualisation.<sup>410</sup> However, subdivisions are still needed in order to implement the fiscal capital contribution principle.<sup>411</sup> These subdivisions are customary in international practice and follow the national and international standards.<sup>412</sup> Furthermore, due to the subdivisions in accounting law, the future amendment to the accounting rules in material law, which regulates the creation and dissolution of reserves, only needs to be updated.<sup>413</sup> Finally, disclosure of the origin and thus the nature of the reserves is legal and important for both their creation and their post-dissolution use.<sup>414</sup>

#### (a) *Capital Reserves*

##### (i) *Actual Accounting Regulations*

121 According to the recently amended accounting regulations, the minimum structure of a balance sheet contains the item “capital reserves”.<sup>415</sup> Before this amendment, capital reserves and profit reserves were both allocated to the general reserves.<sup>416</sup> The material law that governs the creation and dissolution of capital reserves will be updated.<sup>417</sup>

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<sup>407</sup> Art. 959a par. 2 no. 3 literae b and c CO.

<sup>408</sup> Cf. BÖCKLI, Rechnungslegung, par. 455 and 508.

<sup>409</sup> Botschaft 2008, p. 1659.

<sup>410</sup> Botschaft 2008, p. 1659; AB S 2009, p. 648.

<sup>411</sup> MÄUSLI-AlLENSPRACH/OERTLI, p. 137; see [Paragraph 123 et seqq](#) and [137](#) for further explanation.

<sup>412</sup> Swiss GAAP FER 24 no. 7 and no. 24-25; IFRS Framework Paragraph 4.20. HANDSCHIN, Rechnungslegung par. 827; Botschaft Rechnungslegung 2007, 1706.

<sup>413</sup> Botschaft 2008, p. 1659.

<sup>414</sup> Ibid.

<sup>415</sup> Former Art. 959a par. 2 no. 3 lit. b CO (2007).

<sup>416</sup> See title in the margin Art. 671 CO.

<sup>417</sup> Art. 671 revCO.

(ii) *Creation of Capital Reserves as per the new Company Regulations*

Unlike the current law, the new company legislation does not prescribe two types of allocation;<sup>418</sup> instead, it only allows for a single allocation to be made to the capital reserves,<sup>419</sup> a regulation which will make this norm much easier to understand and apply.<sup>420</sup> Capital reserves are paid-in capital, which is paid in by the equity providers, shareholders or company members, and exceeds share capital.<sup>421</sup> Currently, the legislation is strict in only permitting the allocation of *agio* (additional paid-in capital),<sup>422</sup> profit of forfeiture<sup>423</sup> and capital contributions.<sup>424</sup> Participations such as *à fond perdu* (unrecoverable contributions or non-returnable contributions) contributions count as capital contributions, which have no effect on the profit and loss account.<sup>425</sup> According to BÖCKLI, book profit arising from capital reduction may also be allocated to the capital reserves.<sup>426</sup> Although these book profits can only be used for write-downs, it is not a breach of the ratio legis principle to allocate them to the capital reserves when a write-down is not necessary from a business administrative perspective.<sup>427</sup> The use of book profits, as per Art. 732 par. 4 CO (1991), is typically grounded in a misunderstanding: since book profits are not based on a profit that is recognised in the profit and loss account, an allocation to the capital reserves is permitted.<sup>428</sup>

The subdivision of reserves into capital reserves and profit reserves is crucial due to the tax-free distribution of capital reserves; unlike distributed profit reserves, distributions for privately held shares are not taxed.<sup>429</sup> In order to

<sup>418</sup> Art. 671 par. 1 CO for the first allocation and par. 2 for the second allocation.

<sup>419</sup> Art. 671 par. 1 revCO for capital reserves and Art. 672 par. 1 revCO for profit reserves.

<sup>420</sup> Art. 671 revCO; cf. HANDSCHIN, Rechnungslegung, par. 830.

<sup>421</sup> Botschaft 2016, p. 522.

<sup>422</sup> Art. 671 par. 1 no. 1 revCO.

<sup>423</sup> Art. 671 par. 1 no. 2 revCO.

<sup>424</sup> Art. 671 par. 1 no. 3 revCO. As such, a special item must be listed; Art. 5 par. 1<sup>bis</sup> VStG.

<sup>425</sup> Art. 671 par. 1 no. 3 revCO; BÖCKLI, Rechnungslegung, par. 456 and 513.

<sup>426</sup> BÖCKLI, Rechnungslegung, par. 514.

<sup>427</sup> HWP, p. 232 et seqq.

<sup>428</sup> BÖCKLI, Rechnungslegung, par. 514.

<sup>429</sup> Capital contribution principle according to Art. 20 par. 3 DBG; Art. 7b StHG; cf. HANDSCHIN, Rechnungslegung, par. 828.

prevent double taxation,<sup>430</sup> a separate item for reserves that are created with capital contributions may be listed to indicate any pay-outs to the shareholders or company members.<sup>431</sup>

- 124 As additional financial contributions in LLCs may only be refunded in full or in part if the amount is covered by freely disposable equity capital and this has been confirmed in writing by a licensed audit expert, as per Art. 795b. According to Art. 795a CO, these contributions are not stock capital but capital contributions. They are thus to be listed as separate items within the capital reserves.<sup>432</sup> As the competence to repay falls under the authority of the executive body and thus differs from the competence to distribute reserves, this must also be shown separately from the other capital reserves.<sup>433</sup> A further reason for this is that all company members may not have paid an additional contribution; the additional capital contributions must therefore be shown in a separate capital reserve.<sup>434</sup>

### (b) *Retained Earnings Reserves*

- 125 Retained earnings reserves, also known as profit reserves, are reserves that are created by a statutory allocation of a company's profit, for which Art. 671 CO applies to companies limited by shares, Art. 801 CO to limited liability companies, and Art. 860 to cooperatives.<sup>435</sup>

### (i) *Creation of Retained Earnings Reserves*

- 126 Retained earnings reserves, like statutory reserves, are currently created through two mandatory allocations. For the first allocation, 5% of the company's annual profit<sup>436</sup> must be allocated to the general reserves – up to the limit of 20% of the paid-up share capital.<sup>437</sup> In the new law, this 20% threshold has been more than doubled to 50%.<sup>438</sup> For the second allocation, 10% of the

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<sup>430</sup> Botschaft Rechnungslegung 2008, 1659.

<sup>431</sup> Art. 5 par. 1<sup>bis</sup> VStG; Art. 959a par. 2 no. 3 lit. a CO; see example in KS Nr. 29a, Kapitaleinlageprinzip neues Rechnungslegungsrecht, 4.1.

<sup>432</sup> GLANZMANN/GUIDOUM, FS Handschin, p. 259; HANDSCHIN, Rechnungslegung, p. 199 Fn 1.

<sup>433</sup> GLANZMANN/GUIDOUM, FS Handschin, pp 259 et seqq.

<sup>434</sup> Ibid.

<sup>435</sup> BSK II-NEUHAUS/GERBER, 959a, par. 83.

<sup>436</sup> Art. 959b par. 2 no. 11 and par. 3 no. 8 CO.

<sup>437</sup> Art. 671 par. 1 CO (1991).

<sup>438</sup> Art. 672 par. 2 revCO.

value of the distributions for the profit shares – over and above the payment of a dividend of 5% – must be allocated to the reserves even after the statutory limit has been reached.<sup>439</sup> This valuation system, amounting to 10% of the super dividend, will be removed from the new law.<sup>440</sup> The system of two allocations should be replaced, as it will be in the new law.<sup>441</sup> According to the new law, only one allocation will be required, while 5% of the annual profit may be allocated to the retained earnings reserves.<sup>442</sup> As such, the retained earnings reserves will be supplied from only one source – from either retained earnings or profit – and will function as a forced refinancing for the company.<sup>443</sup> As in the new law, a loss carried forward must be considered before the allocation is completed.<sup>444</sup> The possibility of raising the upper threshold for the allocation to 50% remains. An amendment to the articles of association as they relate to the assembly and its decisions is thus needed.<sup>445</sup>

## (ii) Sub-Categories

The new regulation distinguishes further between statutory and legal retained earnings reserves, as per Art. 672 revCO, and voluntary retained earnings reserves, as per Art. 673 revCO. Under current law,<sup>446</sup> the latter are called reserves pursuant to the articles of association (Art. 672 CO).<sup>447</sup> They give the assembly discretion to create further reserves when this option is stipulated in the articles of association.<sup>448</sup> 127

This sub-category of *legal* retained earnings reserves here, should not be confused with the authority enjoyed by the assembly to create and utilise additional reserves, as per Art. 673 CO (Art. 673 revCO). This category of *voluntary* retained earnings reserves will thus be discussed in a separate chapter.<sup>449</sup> 128

<sup>439</sup> Art. 672 par. no. 3 CO.

<sup>440</sup> Botschaft 2016, p. 524 no. 2.1.13.

<sup>441</sup> Art. 672 par. 1 revCO; Botschaft 2016, p. 524 no. 2.1.13.

<sup>442</sup> Art. 672 par. 1 revCO.

<sup>443</sup> BÖCKLI, Rechnungslegung, par. 521.

<sup>444</sup> Art. 672 par. 1 in fine revCO.

<sup>445</sup> Botschaft 2016, p. 524.

<sup>446</sup> See margin, Art. 672 CO.

<sup>447</sup> Cf. BÖCKLI, Rechnungslegung par. 467.

<sup>448</sup> Cf. Botschaft, 2017 p. 524.

<sup>449</sup> See [Paragraph 142](#). For an overview see [Paragraph 154](#).

(iii) *Sub-Items*

- 129 According to Art. 670 CO (Art. 725c CO), the revaluation amount is stated separately as a revaluation reserve.<sup>450</sup> Revaluation reserves may be listed as separate sub-items within the retained earnings reserves<sup>451</sup> as they are neither capital contributions nor conventional retained earnings reserves.<sup>452</sup> Although accounting law no longer mentions revaluation reserves in the required minimum structure of the balance sheet, according to Art. 959a par. 2 no. 3 CO they should be separated in order to comply with Art. 671b CO (this norm will be deleted and is in force until 31 December 2022).<sup>453</sup> As such, the updated value of each object that has been revaluated should be disclosed.<sup>454</sup>
- 130 According to Art. 659a par. 2 CO, reserves for a company's own capital shares are another sub-item that falls under legal profit reserves.<sup>455</sup> A company must set aside an amount equivalent to the cost of acquiring its own shares as a separate reserve.<sup>456</sup> For example, the purchase price at which a company paid for its own shares or participations is shown on the balance sheet as a liability, and is thus deducted from the equity.<sup>457</sup> The aim of this reserve for own capital shares, which is required as per the minimum structure of the balance sheet, is to list negative items.<sup>458</sup> However, this is only required after the indirect purchase of own shares or participations and not after direct purchases.<sup>459</sup>

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<sup>450</sup> See [Paragraph 68 et seqq.](#)

<sup>451</sup> Cf. HWP, p. 230 et seq; CHK Rechnungslegungsrecht-LIPP, par. 54.

<sup>452</sup> BSK II-NEUHAUS/GERBER, 959a par. 80 et seqq.

<sup>453</sup> HWP, p. 304; see also BÖCKLI, Rechnungslegungsrecht, par. 461.

<sup>454</sup> HWP, p. 298.

<sup>455</sup> See also BSK II-NEUHAUS/GERBER, Art. 959a CO par. 81.

<sup>456</sup> Art. 659a par. 2 CO.

<sup>457</sup> HANDSCHIN, Rechnungslegung, par. 918 et seqq; see also the example in Paragraph 918; HWP, p. 243.

<sup>458</sup> Art. 959a par. 2 no. 3 lit. e revCO.

<sup>459</sup> BSK II-NEUHAUS/GERBER, Art. 959a, par. 85.



#### (4) *Dissolution and Utilisation*

##### (a) *Competence*

As with the creation of legal reserves, the general assembly has the competence to dissolve reserves.<sup>460</sup> After dissolution, this category of reserves can be used for different purposes, as explained below. 131

##### (b) *Utilisation*

A differentiation between the two kinds of reserves in relation to how they are distributed was explicitly rejected and is not the intention of the legislation.<sup>461</sup> Currently, the dissolution and utilisation rules function as a two-step process with the aim of protecting the company's equity. To the extent that it does not exceed one-half of the share capital, utilisation is restricted to covering losses or for measures designed to sustain the company through difficult times, prevent job losses and/or mitigate the consequences thereof.<sup>462</sup> This threshold of 50% is also included in the new legislation,<sup>463</sup> although utilisation is no longer restricted to these three conditions because the corresponding passage has been removed and replaced.<sup>464</sup> According to the new legislation, the utilisation of capital reserves is free; as such, they may be used to repay shareholders or company members.<sup>465</sup> The same applies to the utilisation of profit reserves.<sup>466</sup> It remains unclear what precisely is meant by these measures since a huge scope of discretion already exists within the provisions, write-downs and value adjustments outlined in Art. 960a par. 4 CO and Art. 960e par. 3 no. 4 CO.<sup>467</sup> 132

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<sup>460</sup> Cf. HANDSCHIN, Rechnungslegung, par. 834.

<sup>461</sup> Botschaft 2008, p. 1659; AB S 2099, p. 648.

<sup>462</sup> Art. 671 par. 3 CO.

<sup>463</sup> Art. 671 par. 2 revCO. For holding companies, the future threshold is only 20%. Art. 671 par. 3 and 672 par. 2 in fine CO.

<sup>464</sup> Art. 671 Abs. 2 revCO.

<sup>465</sup> Art. 671 par. 2 revCO.

<sup>466</sup> Art. 672 par. 3 CO.

<sup>467</sup> Botschaft 2016, p. 523.

- 133 The new legislation is very liberal and corresponds to the Federal Supreme Court's latest case law<sup>468</sup> as well as the aims of the 2007 draft legislation.<sup>469</sup> According to the current legislation, the utilisation of legal reserves is only optional when the reserves exceed 50% of the share capital or the participation capital<sup>470</sup> and legal reserves may be repaid to the shareholders or company members.<sup>471</sup> Current law as well as in the recently changed norms permit the offsetting of reserves and losses.<sup>472</sup> The new legislation thus serves to update the case law by removing the second step from the regulations.
- 134 Finally, for the freely disposable portion of the reserves, the question arises as to whether a distribution of the reserves must be rebooked, since Art. 675 par. 2 CO states that dividends may be paid out only from the disposable profit or from reserves created for this purpose.<sup>473</sup> This would involve a rebooking from the capital reserve or agio to the retained earnings reserve or a reserve for distribution purposes.<sup>474</sup>
- 135 The wording in the official English translation is less clear when compared to the German, French and Italian; disposable profit is translated as "the profit arising from the balance sheet". However, in the context of distribution and by clarifying that this is not yet an established term, the English version seems more precise. As GLANZMANN rightly recognises, the net-profit is not a defined nor reported measure or item on the balance sheet.<sup>475</sup> Equally, the English version refers to a disposable profit that must be calculated based on the threshold explained above, and is thus only provisional. At first glance, "a disposable profit" is more accurate and easier to understand as it denotes a value that is still to be calculated. Furthermore, a rebooking based only on the phrase "from the resulting profit of the balance sheet and from reserves formed for this purpose" appears unusual, since the freely disposable portion of the capital reserve does not arise out of the retained earnings. Additionally, this wording is not practicable and is effectively a dead letter; furthermore, as with the last

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<sup>468</sup> BGE 140 533 consideration 6.2.2.

<sup>469</sup> AB S 2009 pp 647 et seqq; Botschaft 2016, p. 523.

<sup>470</sup> Art. 656a par. 2 CO. In the revised legislation, Art. 656a par. 2 CO will not change.

<sup>471</sup> Art. 671 par. 3 CO a contrario.

<sup>472</sup> For the actual legislation: BSK II-NEUHAUS/BALKANYI, 671 par. 26. In the revised legislation, this option is self-evident because of Art. 674 par. 1 no. 4 CO, and therefore does not need to be repeated. Botschaft 2016, p. 522.

<sup>473</sup> OSER/VOGT, GesKR 1/2012, p. 21.

<sup>474</sup> OSER/VOGT, GesKR 1/2012, p. 21.

<sup>475</sup> See GLANZMANN for further information: GLANZMANN/GUIDOUM, FS Handschin, p. 261 et seqq.

accounting revision as well as in the new legislation, a clear visual separation between both types of reserves based on their origin is clearly expected. As such, a rebooking requirement would correspond with the new separation between capital reserves and retained earnings reserves.<sup>476</sup>

### (c) *Distribution of Agio*

According to Art. 671 par. 3 CO (Art. 671 par. 2 revCO), when the reserves exceed 50% of the share capital, the utilisation of legal reserves is optional and may be used to repay the shareholders or company members. As there is no clarification as to whether this is applicable to agio, the inverse would appear obvious.<sup>477</sup> However, because agio is additional paid-in capital – and not income – it could be classified as protected capital.<sup>478</sup> As a basic norm, Art. 680 par. 2 CO protects the company's capital from its own shareholders or company members to the benefit of the minority shareholders, company members associates and creditors<sup>479</sup> by prohibiting any repayment of paid-in capital to the shareholders or company members.<sup>480</sup> Like stock capital, agio appears in the articles of association (Art. 626 no. 3 CO; Art. 626 no. 3 revCO) and on the balance sheet (Art. 959a par. 2 no. 3 lit. b CO) as well as in the commercial register (Art. 45 Abs. 1 lit. h HRegV), thus serving to inspire trust among the creditors.<sup>481</sup> In light of the additional capital protection for creditors, it would be contradictory for agio – directly after being determined – to be paid back immediately.<sup>482</sup> This inconsistency could arise from the lack of subdivisions for capital reserves and profit reserves" i.e. the fact that capital reserves and profit reserves are not subdivided into further categories.<sup>483</sup>

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<sup>476</sup> For another opinion, see GLANZMANN/GUIDOUM, FS Handschin, p. 261 et seqq.

<sup>477</sup> See also BSK OR-NEUHAUS/BALKANYI, Art. 671 par. 31; HWP, p. 232; see GIGER, 89 et seqq.

<sup>478</sup> See also ZK-JUNG, Art. 624, par. 49; BÖCKLI, Aktienrecht § 1, par. 178; STOFFEL, par. 1093.

<sup>479</sup> Cf. BSK II-VOGT, 680 par. 1 et seq.

<sup>480</sup> Art. 680 par. 2 CO.

<sup>481</sup> ZK-JUNG, Art. 624, par. 49; see CHK-SCHMID, Art. 680 par. 12 for an opposing opinion.

<sup>482</sup> ZH-JUNG, Art. 624, par. 49.

<sup>483</sup> Cf. BSK II-VOGT, 680 par. 19; ZK-JUNG, Art. 624, par. 49.

- 137 Finally, following the leading doctrine,<sup>484</sup> the Federal Supreme Court decided that agio should be treated in the same way as reserves, and should thus enjoy no capital protection.<sup>485</sup> This is a convincing position because the revision of the legislation allows for the distribution of agio by introducing a capital contribution principle and requiring ultimate compliance therewith.<sup>486</sup>
- 138 Since the new legislation subdivides legal reserves according to their origin and characteristics, the disputed question again becomes relevant as *lex specialis* applies to both types of legal reserve; in view of this differentiation, it is necessary to ask again whether the protection of pay-outs or the rules on reserves prevail.<sup>487</sup> In line with the Federal Supreme Court's decision, the new legislation permits pay-outs of capital reserves in Art. 671 par. 2 revCO.<sup>488</sup> Although the subdivision is derived from tax law, this does not result in a change in how both types of legal reserve are viewed, since the rules for determination and usage are identical for both: Art. 672 CO par. 3 revCO refers to the rules for capital reserves on the determination of retained earnings reserves in Art. 671 revCO. As such, the new legislation does not clarify how agio should be treated; on the contrary, in order to protect agio, no differentiation between capital and profit reserves has been made.
- 139 The new, more liberal regulations are not to be seen as being opposed to capital protection, but rather as favouring decisions taken by the general assembly. Ultimately, a pay-out must follow certain rules and is not completely free:<sup>489</sup> it may only be effected if the legal capital and profit reserves, less the value of any losses, exceed half the value of the share capital, as entered into the commercial register.<sup>490</sup>

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<sup>484</sup> KÄGI, p. 290 et seqq; OSER/VOGT, *passim*; HANDSCHIN, *Rechnungslegung*, par. 837; GLANZMANN/WOLF, p. 7; CR-CHENAUX, Art. 678 par. 14 et seqq.

<sup>485</sup> Cf. BGE 140 III 533 consideration 6.2.2.

<sup>486</sup> Art. 5 par. 1<sup>bis</sup> VStG; Art. 20 par. 3 DBG; Art. 7b StHG; Cf. GLANZMANN/WOLF, *GesKR 2014/2*, p. 264 et seqq.

<sup>487</sup> See a special capital reserve for agio: Art. 959a par. 2 no. 3 lit. b CO and Art. 671 revCO (capital reserve) and Art. 672 revCO (retained earnings reserve); ZK-JUNG, Art. 624, par. 49.

<sup>488</sup> GLANZMANN/WOLF, *GesKR 2014/2*, p. 264 et seqq.

<sup>489</sup> *Botschaft 2016*, p. 523.

<sup>490</sup> Art. 671 par. 2 revCO (Art. 671 par. 3 CO).

## (5) Holding Companies

For holding companies,<sup>491</sup> there is some relief available for the creation and dissolution reserves. As the second allocation is not required for holding companies,<sup>492</sup> the threshold for the optional utilisation of legal reserves is not applicable.<sup>493</sup> According to one opinion, the threshold already applies at 20%,<sup>494</sup> but according to another the threshold applies at 50%.<sup>495</sup> 140

The new legislation resolves this discrepancy by stating clearly that the threshold for holding companies applies at 50%.<sup>496</sup> Norms relating to the creation of capital reserves in holding companies are not found in Art. 671 CO, while Art. 672 CO states that profit reserves may be allocated until they and the capital reserves amount to 20% of the paid-up share capital.<sup>497</sup> This regulation is thus applicable to both these categories of reserves. 141

### 2.1.3. Voluntary Reserves

Unlike legal reserves and accounting reserves, voluntary reserves<sup>498</sup> or voluntary retained earnings reserves, as they are termed in the new law,<sup>499</sup> are not statutory but rather based on the articles of association,<sup>500</sup> as will be shown in [Paragraph 144](#). Where a provision is not made for such reserves in the articles of association, the general meeting may not decide to allocate disposable profit to form a further reserve.<sup>501</sup> The latter situation is more common in practice.<sup>502</sup> 142

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<sup>491</sup> According to Art. 671 par. 4 CO, holding companies are companies whose primary purpose is to hold equity participations in other companies.

<sup>492</sup> Art. 671 par. 2 no. 3 in conjunction with par. 4 CO.

<sup>493</sup> Art. 671 par. 3 in conjunction with par. 4 CO.

<sup>494</sup> HWP, p. 237; BSK-II, NEUHAUS BALKANYI, Art. 671 par. 38.

<sup>495</sup> ZK-BÜRGI, 671 par. 118.

<sup>496</sup> Art. 671 par. 3 and 672 par. 3 revCO.

<sup>497</sup> Art. 672 par. 3 revCO.

<sup>498</sup> BSK II-VOGT, Art. 675 par. 21. I use the term “legal reserves” here because I consider it the best way to describe these reserves and differentiate them from accounting reserves.

<sup>499</sup> Art. 673 revCO and already in the accounting regulations.

<sup>500</sup> Art. 672 par. 1 CO. See also Cf. BSK II-NEUHAUS/BALKANYI, 672 par. 2.

<sup>501</sup> Art. 674 par. 3 CO. Both types of reserves are included in Art. 673 par. 1 revCO.

<sup>502</sup> CR-TORRIONE/BARAKAT, Art. 671b-672, par. 2.

143 Noteworthy is the fact that only terminological changes were made, not substantive changes.<sup>503</sup> Although they represent a potentially useful instrument in practice, voluntary reserves are not utilised as often as would be expected. Given that they are created and disclosed by the general assembly, they are both transparent and prudent. Voluntary reserves, like typical reserves, prevent distribution and therefore increase the qualifying protected equity.<sup>504</sup> According to Art. 959a par. 2 no. 3 lit. d CO, since voluntary reserves are formed at the discretion of the general assembly and do not represent statutory reserves, it is mandatory to disclose them as negative items.<sup>505</sup> They are thus reported as sub-items under the retained earnings reserves.<sup>506</sup>

## (1) *Reserves Based on the Articles of Association*

### (a) *Requirements*

144 In contrast to reserves created for specific purposes, voluntary reserves<sup>507</sup> or in the actual terminology – reserves based on the articles of association<sup>508</sup> – are free and independent from almost any requirement.<sup>509</sup> Their only requirements are that there is sufficient, freely available equity and that the reserves were formed in the manner required by law.<sup>510</sup> Finally, for voluntary reserves formed through the articles of association, the latter are determinative. A resolution passed by the general meeting is required to formulate new articles of association.<sup>511</sup>

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<sup>503</sup> Botschaft 1983 p. 165.

<sup>504</sup> HANDSCHIN, Rechnungslegung, par. 838; cf. BSK II-NEUHAUS/BALKANYI, 672 par. 5.

<sup>505</sup> BSK II-NEUHAUS/BALKANYI, Art. 672, par. 6a; cf. Botschaft 2008, p. 1480; also BSK II-NEUHAUS/BALKANYI, Art. 673, par. 9.

<sup>506</sup> Art. 672 par. 1 CO; cf. CHK-IMARK/LIPP, Art. 672 par. 1.

<sup>507</sup> Art. 673 par. 1 revCO.

<sup>508</sup> Art. 672 CO.

<sup>509</sup> CR-TORRIONE/BARAKAT, Art. 671b-672, par. 4; cf. VON BÜREN/STOFFEL/SCHNYDER, par. 911.

<sup>510</sup> CHK-IMARK/LIPP, Art. 672 par. 4.

<sup>511</sup> According to Art. 703 CO, the general meeting passes resolutions by an absolute majority of the represented voting rights. See also ZK-BÜRGI, Art. 672, par. 16 and SCHUCANY, par. 2. In contrast, IMARK/LIPP state that an absolute majority is not required CHK-IMARK/LIPP, 672 par. 2.

As for all types of reserve, the irrevocable right to a dividend also acts as a restriction on the creation of reserves; even a decision by the general assembly should not be able to revoke this right.<sup>512</sup> This restriction is rightfully justified, since the objective of a company limited by shares is to make a profit for its shareholders; as such, according to Art. 673 par. 2 revCO (Art. 674 par. 2 CO), the creation of additional reserves must be justified with a view to the long-term prosperity of the company or the desirability of a stable dividend and being in the interest of all shareholders.<sup>513</sup> Generally, a comparison with the equivalent regulations in Germany shows that one of the main goals of an annual account requirement is to ensure a minimum distribution of profit in the form of a guaranteed dividend,<sup>514</sup> especially for minority shareholders.<sup>515</sup> Consequently, without going too deeply into the substance of German corporate law, financial accounting is responsible for providing this information in order to avoid unproductive minority-owned shares, as will be shown in [Paragraph 177](#) on the principles.

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### (b) Articles of Association

On the one hand, as per Art. 671 par. 1 CO, the articles of association may be utilised to make further allocations: amounts greater than 5% of the annual profit may be allocated to reserves or the reserve must contain more than the 20% of paid-up share capital required by law.<sup>516</sup> On the other hand, the articles of association may be used to form further reserves, whose purpose and use must be specified.<sup>517</sup> These two wording options are no longer spelled out in the new law, but their substance is still applicable since it is self-evident, and thus does not need to be repeated in the new law. In Art. 673 par. 2 CO, however, the new law does stipulate an apparent restriction that limits the formation of voluntary reserves to situations in which they are justified by the long-term prosperity of the company or the interests of the shareholders.<sup>518</sup> This condition is already stipulated in the CO but is expressed in quite vague and open terms.<sup>519</sup>

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<sup>512</sup> BÖCKLI, § 12 par. 512 et seq; VON BÜREN/ STOFFEL/WEBER, par. 883 et seq; for the opposite opinion: GREYERZ, p. 156; BGE 72 II 293; ZK-BÜRGI, Art. 660 par. 25 with further cases.

<sup>513</sup> Cf. SIMONIELLO, FS Handschin, pp 595 et seqq.

<sup>514</sup> MERKT, § 1 par. 217.

<sup>515</sup> MOXTER, p. 56.

<sup>516</sup> Art. 672 par. 1 CO.

<sup>517</sup> Art. 672 par. 2 CO.

<sup>518</sup> Botschaft 2016, p. 524.

<sup>519</sup> See Art. 674 par. 2 no. 2 CO; Art. 960a par. 4 CO and 960e par. 3 no. 4 CO.

- 147 This explains why Botschaft states explicitly that this restriction applies only when reserves are used for non-business-related reasons, such as undermining the interests of the minority shareholders or artificially lowering the share price through low distributions.<sup>520</sup> Ultimately, what TORRIONE/BARAKAT correctly note in relation to the current legislation is still valid: as per Art. 672 par. 2 CO, the articles of association can allow for huge discretion in the use of reserves.<sup>521</sup> Even before the wording was made more precise in the new law, it was argued that the restrictions are an abuse of rights as per Art. 2 CC,<sup>522</sup> especially the shareholders' right to a share of the profits outlined in Art. 660 par. 1 CO.<sup>523</sup> Similarly, this criticism is also valid for the restrictions on reserves created and released by the general meeting, which will be more explicit in the new law<sup>524</sup> because both will be mentioned in the same norm and sentence.
- 148 Furthermore, the articles of association are not only required to stipulate the use and purpose of the reserves, but they must also define the basis for calculating the reserves – namely, the annual profit and share capital, before or after the distribution of dividends.<sup>525</sup> Despite the relatively few other rules that apply to the articles of association, the use of reserves follows the general rules of profit use.<sup>526</sup> Any amendment or annulation of the articles of association or of the use or purpose of the reserves falls under the competence of the general assembly, as does the formation of reserves.<sup>527</sup>

### (c) *Formation and Dissolution*

- 149 The general assembly has the authority to create reserves.<sup>528</sup> The general assembly can also decide how to use or allocate the disposable profit, although this must occur after a proposal by the board of directors.<sup>529</sup> Dissolution occurs when the reserves are used for their stipulated purpose. In case the reserves are not used as stipulated in the articles of association, the board of di-

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<sup>520</sup> Botschaft 2016, p. 524.

<sup>521</sup> CR-TORRIONE/BARAKAT, Art. 671b-672, par. 8.

<sup>522</sup> BÜRGI-ZH, Art. 672 par. 8 et seqq.

<sup>523</sup> CR-TORRIONE/BARAKAT, Art. 671b-672, par. 8.

<sup>524</sup> Art. 673 par. 1 CO.

<sup>525</sup> SCHUCANY, par. 2.

<sup>526</sup> BSK II-NEUHAUS/BALKANYI, Art. 672 par. 5.

<sup>527</sup> Art. 698 par. 2 no. 1 CO; BSK II-NEUHAUS/BALKANYI, Art. 672 par. 8.

<sup>528</sup> Art. 698 Abs. 2 no. 4 CO.

<sup>529</sup> Art. 698 par. 2 no. 4 CO; proposals by the board of directors are subject to oversight by the external auditors, CHK-IMARK/LIPP, Art. 672 par. 5.



rectors and any shareholder may challenge this decision in the general meeting.<sup>530</sup> As already mentioned, the general assembly may amend or annul the articles of association as well as determine their substance.<sup>531</sup>

#### (d) *Special Sub-Type: Staff Welfare*

The current CO recognises two types of reserves that are based on and/or provided for by the articles of association: the general reserves outlined in Art. 672 CO (Art. 673 revCO) and a special category of reserves that is only for the purposes of staff welfare, as stipulated in 673 CO.<sup>532</sup> The function of the latter is to establish optional pension plans for foundations or to provide support for existing foundations<sup>533</sup> rather than statutory pensions plans.<sup>534</sup> Due to the declining importance of staff welfare reserves,<sup>535</sup> they are not included in the revised CO.<sup>536</sup> 150

#### (2) *Reserves based on a Resolution*

Resolution reserves<sup>537</sup> are also known as ad hoc reserves or extraordinary reserves,<sup>538</sup> which provide an accurate description of their function. The general meeting may decide to form reserves for which there is no provision in law or in the articles of association for the following three purposes: replacement, the long-term prosperity of the company, or the distribution of a stable dividend.<sup>539</sup> 151

Formation of such reserves is thus based solely on a resolution of the general assembly and allowed only for these purposes, as stipulated in the CO, while reserves based on the articles of association are permitted for almost unrestricted reasons as long as they have a corresponding basis in the articles of 152

<sup>530</sup> Art. 706 CO.

<sup>531</sup> See [Paragraph 144 et seqq.](#)

<sup>532</sup> CHK-IMARK/LIPP, Art. 672 par. 1; BSK II-NEUHAUS/BALKANYI, Art. 673 par. 2.

<sup>533</sup> ZK-BÜRGI, 674, par. 30.

<sup>534</sup> According to labour law, this is covered by pension fund foundations. The legislation created new norms, such as CC 89<sup>bis</sup> in foundation law as well as some protective rules in the BVG.

<sup>535</sup> GREYERZ, p. 237, BSK II-NEUHAUS/BALKANYI, Art. 673 par. 6.

<sup>536</sup> Botschaft 2016, p. 525.

<sup>537</sup> Art. 674 par. 2-3 CO or 673 par. 1 revCO.

<sup>538</sup> CR-TORRIONE/BARAKAT, Art. 674 par. 5.

<sup>539</sup> Art. 674 par. 2 no. 2 CO. This occurs by means of a simple resolution. BSK II-NEUHAUS, BALKANYI, Art. 674, par. 9 CO.

association.<sup>540</sup> This open-ended wording grants the general assembly enormous discretion.<sup>541</sup> It is especially important to note here that the requirements for the formation of open resolution reserves are the same as for the formation of hidden reserves for replacement purposes<sup>542</sup> as well as for administrative reserves<sup>543</sup>.<sup>544</sup> Consequently, the general assembly has the competence to form resolution reserves, while the board of directors has the competence to form the mentioned hidden reserves or hidden reserves for replacement purposes. This work maintains a clear preference for the formation of open reserves. Particularly noteworthy in relation to resolution reserves is that the CO explicitly stipulates that they must be justified and in the best interests of the shareholders.<sup>545</sup>

153 The new law proposes combining resolution reserves with reserves based on the articles of association.<sup>546</sup> The formation of such reserves will be allowed only with a view to the long-term prosperity of the company and the interests of the shareholders.<sup>547</sup> However, the new option of forming reserves for replacement purposes or in order to ensure a stable dividend will be removed.<sup>548</sup> The reason for their removal lies in the current option that already allows for additional depreciation and valuation adjustments for replacement purposes<sup>549</sup> and which also permits depreciation and valuation adjustments as well as provisions that secure the long-term prosperity of the company,<sup>550</sup> thereby giving companies a large degree of discretion.<sup>551</sup> Finally, the general meeting may decide to allocate disposable profits in order to form reserves for

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<sup>540</sup> BSK II-NEUHAUS/BALKANYI, Art. 674 par. 8; CR-TORRIONE/BARKAT, Art. 674 par. 5.

<sup>541</sup> CHK-IMARK/LIPP, Art. 674 par. 3.

<sup>542</sup> Art. 960a par. 4 CO.

<sup>543</sup> Art. 960e par. 3 no. 4 CO.

<sup>544</sup> Botschaft 2016, p. 896, BOEMLE/LUTZ, pp 170 et seqq, 382 et seqq; HOMBURGER, p. 59.

<sup>545</sup> Art. 674 no. 2 CO in fine. In Art. 674 no. 1 CO, which relates to reserves for replacement purposes, this protection for shareholders is unfortunately not mentioned. See Art. 674 par. 2 no. 1 CO.

<sup>546</sup> See Art. 673 par. 1 revCO, according to which the general assembly may create freeprofit reserves via the articles of associations or by a resolution.

<sup>547</sup> Art. 673 par. 2 revCO.

<sup>548</sup> See Art. 674 par. 2 no. 1 and 2 CO and Art. 673 par. 2 revCO; Botschaft 2016, pp 524 et seqq.

<sup>549</sup> Art. 960a par. 4 CO.

<sup>550</sup> Ibid.

<sup>551</sup> Botschaft 2016, p. 525.

the establishment and funding of welfare schemes for the company's employees or for other welfare purposes, even when such reserves are not provided for in the articles of association.<sup>552</sup> This option will also be removed.<sup>553</sup>

### Overview: Open Reserves in the CO

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TYPE	GENERAL DIVISION (Statutory or voluntary)	ARTICLE	POWER or competence
<b>Statutory Reserves</b>			
<b>Accounting Reserves</b>	Revaluation Reserve	<b>Art. 725c revCO</b> (Art. 670 CO)	Board of Directors
	Fluctuation Reserve	<b>Art. 960b II CO</b>	
	(Negative Reserve [for Own Shares])	<b>Art. 659a IV revCO</b> (Art. 659a II CO)	
<b>Legal Reserve</b>	Capital Reserve	<b>Art. 671 revCO</b> (Art. 671)	General Assembly
<b>Legal Reserve</b>	Retained Earnings Reserve	<b>Art. 672 revCO</b> (Art. 671 CO)	General Assembly
<b>Voluntary Reserves or Reserves at the Discretion of the General Assembly</b>			
	Voluntary Retained Earnings Reserve  Subdivided in: – Reserve based on the Articles of Association (Cl. 1) – Reserve based on a Resolution (Cl. 2)	<b>Art. 673 revCO</b> (Art. 672 CO)	General Assembly

<sup>552</sup> Art. 674 par. 3 CO.

<sup>553</sup> Botschaft 2016, p. 525.

## 2.2. Subdivision in Banking Practice

### 2.2.1. Reserves for General Banking Risks as a Special Reserve

#### (1) Nature

- 155 Open reserves, including reserves for general banking risks, represent equity: In the banking sector, reserves for general banking risks<sup>554</sup> qualify as Common Equity Tier 1 (CET 1).<sup>555</sup> However, due to the fact that the board of directors has the competence to create and release them, they could also be defined as hidden reserves even though they are disclosed.<sup>556</sup> This proximity to hidden reserves as well as to accounting reserves is only based on the board of directors' competence to create and dissolve such reserves, a competence which typically belongs to the general assembly.

#### (2) Notion

- 156 Reserves for general banking risks<sup>557</sup> are a special category of reserves that only exists in the banking sector, and thus cannot be used in the non-banking sector.<sup>558</sup> These reserves, which are created with retained earnings that have not been assigned to another reserve, serve as a hedge to cover the bank's business risks.<sup>559</sup>

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<sup>554</sup> As long as no corresponding provision has been formed. See Art. 21 lit. c ERV.

<sup>555</sup> Art. 21 lit. b and c ERV.

<sup>556</sup> Cf. ARPAGAU/STADLER/WERLEN, par. 2806.

<sup>557</sup> FINMA-Circ 2020/1, par. 18, Art. 46 ReIV-FINMA (for reliable assessment statutory single-entity financial statements) and Art. 59 ReIV-FINMA (for true and fair view single-entity financial statements). The former legal basis is Art. 25 par. 1 no. 2.10 prior BankV as well as the notes of the BankV.

<sup>558</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 312; HANDSCHIN, Rechnungslegung, par. 841a.

<sup>559</sup> GMÜR, Krisenfeste Schweizer Banken?, p. 173; BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 312; HANDSCHIN, Rechnungslegung, par. 841a; Annex 7 to FINMA-Circ 15/1, Glossary, Reserves for general banking risks; BOEMLE/GESELL/JETZER/NYFFELER/THALMANN, p. 900.

### (3) *Competence to Create and Release*

The creation of reserves for general banking risks falls under the competence and discretion of the board of directors.<sup>560</sup> The banking regulations do not provide any detailed rules in this regard, nor is the maximum value fixed.<sup>561</sup> This competence can be compared in some ways to the board of directors' competence to create hidden reserves; as reserves for general banking risks represent undisclosed equity, this justifies their creation to the same value as hidden reserves.<sup>562</sup> Fundamentally, however, the creation of reserves for general banking risks should fall under the competence of the general assembly. In the case of reserves for general banking risks, a transfer of competences to the executive body occurs. Such a transfer is advisable and could thus potentially also be effected for other types of reserves that are similar to reserves based on the articles of association. However, the competence to create and dissolve reserves falls under the competence of the general assembly and the latter should at least be able to decide whether to effect a transfer of competences: reserves based on the articles of association could provide the opportunity for a legitimate transfer of competences. Hence, the transfer of competences effected through reserves for general banking risks can be completed without the permission of the general assembly, which would otherwise be competent for decisions on equity and whose authority for any related decisions would normally be required.

Thus, reserves for general banking risks represent a transgression of the general assembly's competences and its authority.<sup>563</sup>

The creation and release rules for reserves for general banking risks are found in the Swiss Financial Market Authority's circular. However, the appropriate place for such rules of creation and dissolution should be at the level of a law due to the fact that these creation and dissolution rules transfer a competence that usually falls under the authority of the general assembly to the board of directors. It is possible to form a reserve for general banking risks by disclosing it (1) via the item "changes in reserves for general banking risks"; (2) via a reallocation of hidden reserves to the item "provisions"; or (3) on the basis of a

<sup>560</sup> GMÜR, *Krisenfeste Schweizer Banken?*, p 173; Cf. HANDSCHIN, *Rechnungslegung*, par. 841a; cf. MEYER/NAGEL-JUNGO, *ST 8/2014*, p 614.

<sup>561</sup> FINMA-Circ 2020/1; RelV-FINMA.

<sup>562</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 316.

<sup>563</sup> Cf. BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 316; cf. MEYER/NAGEL-JUNGO, *ST 8/2014*, pp 604 et seqq, 614.

reallocation of value adjustments and provisions<sup>564</sup> that were previously financially necessary.<sup>565</sup> As such, reserves for general banking risks are created by inserting the item “changes in reserves for general banking risks” into the income statement; by way of a transfer of hidden reserves; or, in the case of reliable assessment single-entity financial statements, by a redesignation of value adjustments and provisions that are no longer financially necessary.<sup>566</sup> This use of the income statement for reserves for general banking risks is unique to Switzerland.<sup>567</sup> This solution involving reserves for general banking risks is more optimal than the creation of hidden reserves, but the legal basis for a transfer of competences is still insufficient. Such a transfer could either be anchored in a Federal Act or in the articles of association. In the case of the latter, this would allow the general assembly to decide on when to permit and effect a transfer of competences.

- 160 Reserves for general banking risks may only be released via the item “changes in reserves for general banking risks” on the income statement.<sup>568</sup> As with provisions, it is possible – and, indeed, a good solution – to recognise reserves for general banking risks in the profit and loss account.<sup>569</sup>

#### (4) *Impact on Tax*

- 161 Crucially, reserves will only be legitimate if they have an impact on taxable income, which is convenient. In true and fair view single-entity financial statements, reserves for general banking risks are to be recognised through the profit and loss account. It is explicitly stipulated that reserves for general banking risks as well as the newly allocated amount must be considered for tax purposes,<sup>570</sup> the creation of reserves for general banking risks thus represents a clear advantage from a fiscal perspective.
- 162 By contrast, for reliable assessment statutory single-entity financial statements, the formation of reserves for general banking risks does not always affect the profit and loss account when resulting from a reallocation of hidden

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<sup>564</sup> Where these have been created by charging the item “changes” to provisions and other value adjustments and losses.

<sup>565</sup> FINMA-Circ 2020/1, par. 33 et seqq.

<sup>566</sup> Annex to FINMA-Circ 2020/1, par. 126; annex to FINMA-Circ 2020/1 par. 121.

<sup>567</sup> MEYER/NAGEL-JUNGO, ST 8/2014 p. 614.

<sup>568</sup> Annex to FINMA-Circ 2020/1 par. 122.

<sup>569</sup> See a different opinion in MEYER/NAGEL-JUNGO, ST 8/2014 p. 614.

<sup>570</sup> Art. 59 RelV-FINMA.

reserves.<sup>571</sup> However, the new legislation generally recognises reserves for general banking risks through the profit and loss account,<sup>572</sup> in contrast to the old legislation, which only requires disclosure of their tax status.<sup>573</sup> Additionally, according to the new legislation, reserves for general banking risks must also be listed in the cash flow statement under the operating activities.<sup>574</sup>

### (5) Reserves for General Banking Risks or Provisions?

Provisions, like reserves for general banking risks, are instruments for the prevention of risk – from a financial perspective, both instruments are reserves for likely yet uncertain future outgoing cash flows.<sup>575</sup> From a terminological perspective, both instruments are reserves for possible future outgoing cash flows, although reserves for general banking risks are created for unlikely risks and provisions for probable risks.<sup>576</sup> Both have the same impact on the company's profit: they allow the accumulated earnings to be correspondingly reduced until the requirements for distribution are no longer fulfilled.<sup>577</sup> Thus, from a technical point of view, as long as the equity is still covered both reserves for general banking risks as well as provisions comply with the rules on capital protection and preservation.<sup>578</sup>

An important difference is that the creation of provisions is mandatory if the requirements are fulfilled, which means that a banking entity does not have a choice between a reserve for general banking risks or a provision.<sup>579</sup> Another fundamental difference is that reserves for general banking risks are classified as equity while provisions count as liability – or, more precisely, as a reserve for potential liabilities, otherwise known as a reserve for the valuation of potential liabilities.<sup>580</sup> Ultimately, it is not the terminology that is decisive, but rather the fact that provisions, unlike reserves, are not classified as equity.

<sup>571</sup> Art. 46 RelV-FINMA.

<sup>572</sup> Art. 46 RelV-FINMA.

<sup>573</sup> FINMA-Circ 15/1, par. 577.

<sup>574</sup> Annex 5 to FINMA-Circ 2020/1.

<sup>575</sup> BankG Komm-HANDSCHIN, Art. 6, par. 310 et seq.

<sup>576</sup> Cf. BankG Komm-HANDSCHIN, Art. 6, par. 310 et seq.

<sup>577</sup> A loss will result if the newly created reserves are higher in value than the accumulated retained earnings. HANDSCHIN/WIDMER, US Bankendeal, par. 3.

<sup>578</sup> Ibid., par. 14. See also the example in [Paragraph 13](#).

<sup>579</sup> BankG Komm-HANDSCHIN, Art. 6, par. 320.

<sup>580</sup> Ibid., par. 326.

(6) *Addendum: IFRS Compatibility?*

- 165 In practice, according to the IFRS reporting rules, reserves for general banking risks are not applicable to banks.<sup>581</sup> The reason for this non applicability is that no earnings or income is connected to this reserve;<sup>582</sup> however, although this is correct, it is not relevant.<sup>583</sup> According to HANDSCHIN, reserves for general banking risks differ from other types of open reserves only by the fact that they are created by the board of directors.<sup>584</sup> Nonetheless, the creation of reserves is clearly allowed in IFRS accounting when the general assembly has the competence to do so, namely in the case of reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments.<sup>585</sup> However, the difference here is that reserves for general banking risks are not created by the general assembly but by the board of directors.<sup>586</sup>
- 166 In the IFRS, the creation of reserves is sometimes permitted by statute (e.g. the articles of association); other reserves may be established if national tax law grants exemptions from, or reductions in, tax liabilities when transfers to such reserves are made.<sup>587</sup> This applies, for example, to reserves based on the articles of association, for the creation of which the general assembly can pass on the authority to the board, as well as to reserves for general banking risks.<sup>588</sup> The fundamental issue is the status of the newly created reserve in relation to tax, namely if it is disclosed before or after profit. In the IFRS, reserves are created and disclosed on the balance sheet after the profit has been declared,<sup>589</sup> while reserves for general banking risks are formed and entered into the balance sheet before profit.<sup>590</sup>

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<sup>581</sup> BÖCKLI, Aktienrecht, § 8 par. 31.

<sup>582</sup> *Ibid.*, § 8 par. 31.

<sup>583</sup> BankG Komm-HANDSCHIN, Art. 6, par. 319.

<sup>584</sup> BankG Komm-HANDSCHIN, Art. 6, par. 313 and 319.

<sup>585</sup> See IFRS, Framework, 65.

<sup>586</sup> BankG Komm-HANDSCHIN, Art. 6, par. 319.

<sup>587</sup> IFRS, Framework, 66.

<sup>588</sup> Cf. BankG Komm-HANDSCHIN, Art. 6, par. 319.

<sup>589</sup> Reserves are not included in the profit.

<sup>590</sup> BankG Komm-HANDSCHIN, Art. 6, par. 319; Annex 1 to BankV; FINMA-Circ 2020/1, par. 126 and 144.



## 2.2.2. Other Reserves in the CO

In [Paragraph 154](#), all categories of reserves that exist in the CO are listed; however, not all are applicable to financial statements prepared in accordance with the Swiss accounting standards for banks. The following subsections provide an overview of these other types of reserves.

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### (1) *Inapplicable Reserves*

Although fluctuation reserves<sup>591</sup> are a useful concept in the CO, no provision is made for them in the banking regulations. As a result, they are not applicable to financial statements prepared in accordance with the Swiss accounting standards for banks.<sup>592</sup> The reporting of fair value, which has an impact on the profit and loss account, is mandatory for commercial business as well as financial instruments.<sup>593</sup> Consequently, when revaluation does not affect the profit and loss account, a revaluation should not be undertaken; as such, the ban on fluctuation reserves is rational.<sup>594</sup> Although the use of fluctuation reserves is not possible for profits resulting from revaluation, reserves for general banking risks can be utilised: This type of reserve also has an impact on the profit and loss account and thus on the profit resulting from higher value appreciations, which can ultimately be offset with the expenditure from the formation of reserves for general banking risks.<sup>595</sup>

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Revaluation reserves<sup>596</sup> are no longer applicable to banks. Banks could previously make use of revaluation reserves; with Art. 5 BankG having been removed after the Financial Market Supervision Act (FINMAG) entered into force, this is no longer the case.<sup>597</sup> For banks and companies limited by shares, such a revaluation of real estate and participations in excess of their acquisition costs needed to be accepted *de lege lata* and reported to FINMA before the financial statements were published.<sup>598</sup> Additionally, FINMA had to be provided

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<sup>591</sup> Art. 960b par. 2 CO.

<sup>592</sup> Annex 1 to FINMA-Circ 15/1.

<sup>593</sup> See BankG Komm for assets which may not been revaluated to their fair value, BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 342.

<sup>594</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 342.

<sup>595</sup> *Ibid.*, par. 343.

<sup>596</sup> Art. 725c revCO (Art. 670).

<sup>597</sup> ARPAGAUS/STADLER/WERLEN, Bankgeschäft, par. 2826; see also BSK II-NEUHAUS/BALKANYI, Art. 670 par. 45; explicitly: FINMA-Circ 15/1, par. 257.

<sup>598</sup> FINMA-Circ 15/1, par. 257.

with all the information and documents that it requires to carry out its tasks. Furthermore, any incident that was of relevance to this supervision was required to be immediately reported to FINMA.<sup>599</sup> However, the new circular no longer mentions the option to create revaluation reserves.<sup>600</sup> This instrument has been rightfully discontinued for banks, although it remains a powerful instrument that promotes the survival of companies in the non-banking sector. For banks, however, it was inappropriate and thus potentially dangerous. BÖCKLI's general criticisms primarily apply to the banking sector.<sup>601</sup>

170 In relation to hidden reserves,<sup>602</sup> some restrictions apply to banking accounting. These will be detailed in the following chapter on applicable reserves. First, however, it is important to note that hidden reserves are only permitted in reliable assessment statutory single-entity financial statements and not in true and fair view single-entity financial statements.<sup>603</sup> Despite the applicability of hidden reserves to reliable assessment statutory single-entity financial statements in the context of banking accounting, the formation of hidden reserves is not justified due to the option available to the board of directors to form reserves for general banking risks, an alternative which does not apply in the non-banking sector.<sup>604</sup>

171 Because hidden reserves usually have an impact on the profit and loss account, the illegitimate practice of forming hidden reserves in the banking sector – despite the availability of the option to form reserves for general banking risks – is often used<sup>605</sup> although hidden reserves do not always go untaxed, contrary to what would be expected.<sup>606</sup>

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<sup>599</sup> Art. 29 FINMAG.

<sup>600</sup> FINMA-Circ 2020/1, par. 30 and 111.

<sup>601</sup> BÖCKLI, Aktienrecht, § 8 par. 315 et seqq. 387 and 765; BÖCKLI, Rechnungslegungsrecht, par. 466 et seq; ARPAGAU/STADLER/WERLEN, Bankgeschäft, par. 2825.

<sup>602</sup> See [Paragraph 28 et seqq.](#) Additionally, the ancient circular provides a definition in its glossary, according to which hidden reserves are the difference between the book value and the legally permissible maximum value. Forced reserves – defined as the difference between the legal maximum value and the economic real value – are not considered to be hidden reserves.

<sup>603</sup> FINMA-Circ 15/1, par. 240 and 259; FINMA-Circ 2020/1, par. 28.

<sup>604</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 365.

<sup>605</sup> Art. 46 versus Art. 59 RelV-FINMA.

<sup>606</sup> Only very few tax authorities recognise these as business-related expenses, BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 317.

HANDSCHIN proposes optimizing this situation by unifying the taxable implications of hidden reserves in reliable assessment statutory single-entity financial statements: as reserves for general banking risks present an alternative to hidden reserves, it is correct that the creation of a reserve for general banking risks also represents an expense for taxation purposes.<sup>607</sup> 172

## (2) *Applicable Reserves*

Negative reserves<sup>608</sup> are named negative items in banking reporting. Own shares or capital contributions are not allowed to be activated on the balance sheet; nonetheless, a category for negative reserves must be included to show that the share capital has been paid back.<sup>609</sup> Banks' minimum structure is not regulated by the CO but follows the special rules for banking accounting.<sup>610</sup> Own shares must be disclosed separately as a negative item on the balance sheet.<sup>611</sup> The new circular only mentions a "negative item" for "own capital contributions", but this means the same as the old circular's requirement to report own shares as a separate negative equity component so that the value of own shares could be deducted from the equity.<sup>612</sup> Rather than describing it as the value of own shares, it would be more accurate to describe this as distributions or pay-outs as well as the value of service in return.<sup>613</sup> However, from a historical perspective, this can be seen as a positive development considering that it was not mandatory to form a reserve until 2013.<sup>614</sup> It may be argued that, despite the former Art. 25 par. 5 Banking Act, the former Art. 659a par. 2 CO was applicable by referral. 173

Furthermore, general statutory reserves like capital reserves and retained earnings reserves are applicable to banking accounting, with the old circular already having differentiated between capital and profit reserves.<sup>615</sup> It is 174

<sup>607</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 317.

<sup>608</sup> See [Paragraph 97 et seqq.](#)

<sup>609</sup> HANDSCHIN, Rechnungslegungsrecht, par. 918; FINMA-Circ 2020/1, Anhang 1 par. 144.

<sup>610</sup> Art. 28 BankV Anhang 1 BankV; Art. 2 RelV FINMA; BSK II-NEUHAUS/GERBER, Art. 959a par. 96; in contrast, FINMA-Circ 2015/1, par. 584 explicitly mentions Art. 959a par. 2 no. 3 lit. e CO.

<sup>611</sup> FINMA-Circ 2015/1, par. 112; FINMA-Circ 2020/1, Anhang 1 par. 144.

<sup>612</sup> FINMA-Circ 2015/1, par. 584.

<sup>613</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 229.

<sup>614</sup> Art. 25 par. 5 old BankV, Cf. HANDSCHIN, Rechnungslegung, par. 913.

<sup>615</sup> FINMA-Circ 2020/1, par. 131 (capital reserves) and par. 138 (retained earnings reserves); for true and fair view single-entity financial statements see also Art. 67 and Anhang 1 RelV-FINMA.

mandatory for banks to disclose both types of general reserves separately.<sup>616</sup> Additionally, disclosure of separate tax-exempt capital contribution reserves is required.<sup>617</sup> The CO's allocation rules are applicable to banking accounting as well as to the dissolution and utilisation of reserves.<sup>618</sup>

- 175 Finally, since the CO is applicable to banks, voluntary retained earnings reserves may also be used by banks.<sup>619</sup> The old and new circulars do not differentiate between the two types of voluntary retained earnings reserves.<sup>620</sup> Voluntary retained earnings reserves should be disclosed as such as a separate item.<sup>621</sup> The terminology does not differentiate between reserves that are based on the articles of association and the resolution reserves that are outlined in the CO, consequently allowing for a combined disclosure of both types of reserves. The CO's rules, as explained in [Paragraph 149](#), are applicable to the formation as well as the dissolution of voluntary retained earnings reserves.
- 176 As mentioned above, the formation of hidden reserves is permitted for reliable assessment statutory single-entity financial statements, but hidden reserves may only be created in the following specific circumstances: (1) a charge to the profit and loss account due to changes to the provisions and other value adjustments listed under the item "provisions"; (2) conversion of provisions that are no longer required into hidden reserves; (3) reallocation of value adjustments for default risk into hidden reserves under the item "provisions"; (4) a charge to the item "value adjustments" under participations and the depreciation and amortization of tangible fixed assets and intangible assets; (5) an increase in the difference between the book value and the maximum legal limit resulting from market-related rises; or (6) a decision not to revoke a value impairment.<sup>622</sup> As such, from 2020 onwards the option of creating hidden reserves is no longer unrestricted. Correctly, hidden reserves are no longer permitted for replacement purposes or to ensure a bank's long-term prosperity.<sup>623</sup>

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<sup>616</sup> See FINMA-Circ 2020/1: Position or item 215 and 215.

<sup>617</sup> FINMA-Circ 2020/1, N 133; FINMA-Circ 2015/1, par. 109.

<sup>618</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 346 et seqq. For profit reserves, the circular and the CO are both explicitly applicable to the allocation, FINMA-Circ 2020/1, par. 138.

<sup>619</sup> FINMA is replacing the discontinued Art. 5 old BankG, BSK II-NEUHAUS/BALKANYI, Art. 671 par. 45.

<sup>620</sup> FINMA-Circ 2020/1, par. 142; see also Anhang 1 RelV-FINMA, in which voluntary and statutory reserves are combined into one item known as "retained earnings reserves", HANDSCHIN, Rechnungslegung, par. 349.

<sup>621</sup> FINMA-Circ 2020/1, par. 142.

<sup>622</sup> Art. 38 RelV-FINMA.

<sup>623</sup> FINMA-Circ 2015/1, par. 240.

## 3. Regulation of Reserves

### 3.1. Principles of Financial Reporting

#### 3.1.1. Financial Reporting

The obligation to keep accounts and file financial reports, according to Art. 957 par. 1 CO, depends on the sales revenue of the previous financial year.<sup>624</sup> As per Art. 957 par. 1 no. 1 and 2 CO, sole proprietors and partnerships with a sales revenue of at least 500,000 CHF in the last financial year as well as all other legal entities, regardless of their sales revenues, are obligated to keep accounts and file financial reports. As Art. 957 par. 2 no. 1 CO stipulates, sole proprietorships and partnerships with a sales revenue of less than 500,000 CHF in the last financial year only need to account for their income, expenditure and asset position. Nevertheless, the principles of financial reporting remain applicable regardless of sales revenue.<sup>625</sup> 177

Financial accounting must be understood and interpreted in the light of current generally recognised principles: This makes it a very dynamic field, and, consequently, a corresponding body of customary law and an established doctrine and case law as mentioned in Art. 1 par. 2 and 3 CC do not exist.<sup>626</sup> Legislators have left these open to interpretation and for adaptation to new situations and requirements.<sup>627</sup> However, the Fiduciary Chamber's Auditing Commission's *Handbuch der Wirtschaftsprüfung (HWP)* is regarded as established doctrine by the Swiss Federal Court.<sup>628</sup> As a result, the corresponding case law is based on this work, although it has not yet attained normative force.<sup>629</sup> 178

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<sup>624</sup> GLANZMANN, *Gesellschafts- und Handelsrecht*, § 25 par. 48 and 51.

<sup>625</sup> Art. 957 CO.

<sup>626</sup> Botschaft 2007, p. 1697. The newer Art. 958c CO do not mention any further generally recognised commercial principles as per, ancient Art. 957 par. 2 CO, HANDSCHIN, *Rechnungslegung*, par. 26.

<sup>627</sup> BSK II-NEUHAUS/SCHÄRER, Art. 957 par. 30 et seqq.

<sup>628</sup> BGE 136 II 88, consideration 4.4.

<sup>629</sup> BGer 6B\_684/2010 of 15/11/2010 consideration 3.3.3. (not published).

### 3.1.2. The Authoritative Principle

- 179 Given that tax law refers to the profit and loss account, Art. 957 CO et seq. are applicable to taxation.<sup>630</sup> As such, profit tax is based on commercial accounting law and its principles.<sup>631</sup> The Swiss corporate tax system is considered to be more of a profit and gain taxation system than a system depending on the balance sheet.<sup>632</sup> Because the net profit, the difference between the equity of the current year and the last year, is crucial and not only the balance sheet.<sup>633</sup> HANDSCHIN discusses a peculiarity in the Swiss corporate tax system that he argues should be removed: This would involve a move more towards a profit-and-gain system of taxation as opposed to one based on the balance sheet,<sup>634</sup> since not only the latter but also net profit, namely the difference between the equity of the current year and the previous year, is crucial.<sup>635</sup>
- 180 Furthermore, as seen in [Paragraph 161](#) on hidden reserves, not all reserves are fully recognised as reserves in taxes.<sup>636</sup> For example, when hidden reserves and reserves for general banking risks are compared, there is not always a mandatory recognition in taxation, which makes these reserves for general banking risk less attractive.<sup>637</sup>

### 3.1.3. Financial Reporting Principles according to the CO

#### (1) *Going Concern Principle*

- 181 The first principle mentioned by the CO, and therefore its main principle, is the fundamental assumption that an entity is and will remain ongoing for at least the next twelve months from the balance sheet date.<sup>638</sup> Otherwise Art. 958a Abs. 2 CO states that the financial reporting has to be done with re-

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<sup>630</sup> The authoritative principle according to Art. 58 par. 1 lit. a DBG; BGE 137 II 353 E. 6.2; 136 II 88 E. 3.1; 132 I 175 E. 2.2.

<sup>631</sup> See Art. 58 par. 1 lit. a DBG.

<sup>632</sup> HANDSCHIN, Rechnungslegungsrecht, p. 9.

<sup>633</sup> *Ibid.*, according to the dynamic theory, LOCHER, System des schweizerischen Steuerrechts, pp 231 et seq.

<sup>634</sup> HANDSCHIN, Rechnungslegungsrecht, p. 9.

<sup>635</sup> *Ibid.*

<sup>636</sup> Reverse Authoritative Principle, see BSK DBG-BRÜLISAUER/MÜHLEMANN, DBG, Art. 58 par. 15 and 28.

<sup>637</sup> See [Paragraph 62 et seqq.](#)

<sup>638</sup> Art. 958a par. 1 CO; HANDSCHIN, Rechnungslegungsrecht, p. 158.

alisable or liquidation values and no longer with going concern values (acquisition value<sup>639</sup>).<sup>640</sup> The HWP adds that if there is any doubt about the on-going capacity, this fact and the counter-measures should be explained in the notes.<sup>641</sup> When the missing going concern capacity affects only some operating parts the possible consequences should also be indicated.<sup>642</sup> A financial reporting with realisable values and depreciations leads mainly to an immediate decrease of equity, and in the worst case it leads to indebtedness caused by the changed valuation.<sup>643</sup> However, it is important to prevent an entity from becoming overindebted by reporting with acquisition values, a situation which would not occur if it reported with market values.<sup>644</sup> All types of hidden reserves<sup>645</sup> are founded on the premise that the entity will be a going concern for the foreseeable future;<sup>646</sup> hidden reserves must be made visible *only* from the moment when this assumption is no longer applicable. Similar to Art. 725 par. 1 CO, Art. 670, par. 1 CO also has such a mechanism.<sup>647</sup> In order to rectify a negative net worth in a crisis situation, a company may – as an *exception* – revalue land, buildings or equity participations either to their real value or to their realisation value if they were to be sold.<sup>648</sup> The *only* requirement for this revaluation, according to Art. 670 CO, is a negative net worth or, as per Art. 725c par. 1 CO, a negative net worth prior to revaluation.<sup>649</sup> This technique may prevent a crisis and support the going capacity of the entity. As such, revaluation reserves are an instrument to ensure that a company remains a going concern and to avoid an early change of the valuation system while it remains going.

<sup>639</sup> Art. 960a par. 1 CO.

<sup>640</sup> Art. 958a par. 2 CO; MÜLLER/HENRY/BARMETTLER, veb.ch Kommentar, Art. 958a, par. 7; GLANZMANN, Gesellschafts- und Handelsrecht, § 25 par. 165 et seqq.

<sup>641</sup> HWP, p. 35 and p. 61; CHK Rechnungslegungsrecht-LIPP, par. 7.

<sup>642</sup> BSK II-NEUHAUS/SUTER, Art. 958a par. 15 et seqq.

<sup>643</sup> Cf. Art. 725 par. 2 CO (Art. 725b revCO); HANDSCHIN, Rechnungslegungsrecht, par. 306 et seqq 160-161; MÜLLER/HENRY/BARMETTLER, veb.ch Kommentar, Art. 958a, par. 2 and 19 et seq; GLANZMANN, Gesellschaftsrecht und Handelsrecht, § 15 par. 165 et seqq; in German the change is described as the *Sturz vom Bewertungssockel*, HANDSCHIN, FS von Büren, p. 78.

<sup>644</sup> GLANZMANN, SJZ 108/2012, p. 209. Due to the fact that long term assets usually increase in value, MÜLLER/HENRY/BARMETTLER, veb.ch Kommentar, Art. 958a par. 22.

<sup>645</sup> See [Paragraph 32, 38](#) and [46](#).

<sup>646</sup> VIONNET-RIEDERER, par. 352.

<sup>647</sup> Cf. BSK II-NEUHAUS/SUTER, Art. 958a, par. 13; HANDSCHIN, Rechnungslegung, par. 316 and par. 657 et seqq.

<sup>648</sup> Cf. Art. 725c revCO (Art. 670 CO).

<sup>649</sup> CHK, IMARK/LIPP, Art. 670 par. 3; cf. BSK II-NEUHAUS/SUTER, Art. 958a, par. 13.

(2) *Accrual Accounting and the Matching of Revenue and Cost*

182 According to Art. 958b par. 1 CO, financial reporting is based on the principles of chronological and material distinction. Chronological distinction, also known as the accrual basis of accounting, signifies that expenditure or income must be distinguished by date, while material distinction or the principle of matching revenue and costs means that expenditure or income must be distinguished by the nature of the transaction.<sup>650</sup> In other words, financial reporting should be periodical. This principle is based on the dynamic approach according to the *dynamic theory*<sup>651,652</sup>, which focuses on the appropriate and accurate determination of business success and therefore on the development of an entity's financial situation.<sup>653</sup> According to the dynamic approach, reporting thus places an emphasis on the profit and loss account.<sup>654</sup> As early as in the CO of 1936, the legislator was convinced of the importance of the profit and loss account.<sup>655</sup> According to the dynamic approach, the amount of information concerning an entity's financial situation that is provided on the balance sheet is limited; in contrast, in focusing on the balance sheet, the static approach ensures that more information about the real financial situation is provided.<sup>656</sup> However, the dynamic approach serves as a control mechanism for the business and its creditors, because success is defined by comparing profit and loss.<sup>657</sup>

<sup>650</sup> Art. 958b, par. 1 CO. The latter equates to the Anglo-Saxon method for calculating cost of goods sold (COGS), BÖCKLI, Rechnungsleungsrecht, par. 136.

<sup>651</sup> According to SCHMALENBACH. Cf. MOXTER, p. 29; cf. BAETGE/KIRSCH/THIELE, p. 17 et seq. This theory stands in contrast to HERMAN VEIT SIMON's static theory. The latter places more emphasis on the balance sheet, while the determination of profit is secondary; in particular, static theory thus supports a statement of the assets and liabilities as per the balance sheet date.

<sup>652</sup> BEHR/LEIBFRIED, pp 74 and 315; BÖCKLI, Aktienrecht, § 8 par. 180 et seq; BÖCKLI, Rechnungslegung, par. 135; BOEMLE/LUTZ, p. 371; HANDSCHIN, Rechnungslegung, par. 771 et seq; DBG-LOCHER, Art. 29 par. 14 and Art. 63 par. 10.

<sup>653</sup> MOXTER, 30 et seq; BAETGE/KIRSCH/THIELE, p. 17 et seqq.

<sup>654</sup> BAETGE/KIRSCH/THIELE, p. 19; cf. MOXTER, p. 31.

<sup>655</sup> Botschaft 1928, p. 297. See also in [Paragraph 179](#) above, in which it is described how HANDSCHIN criticises Swiss corporate tax law for being based more on profit and loss than on the balance sheet. See also HANDSCHIN, Rechnungslegung, par. 18.

<sup>656</sup> According to HERMAN VEIT SIMON'S. Cf. KÄGI, par. 102.

<sup>657</sup> SCHMALENBACH, par. 25, 52 and 49 et seqq.



The static approach is used as an exception in the CO when the determination of assets is made with an assumption of liquidation and, as such, that the entity is not a going concern. The static approach thus makes use of liquidation values.<sup>658</sup> Dynamic reporting has the advantage of placing more attention on the calculation of dividends,<sup>659</sup> while the reserves are made more visible by the static approach. Keeping in mind that the calculation of dividends is also one of the main purposes of an annual report.<sup>660</sup> As a result, a dual approach provides the most information about an entity's current financial situation as well as the development thereof. 183

Finally, a business transaction is dated according to the period in which it is enacted and not by the period in which payment is made.<sup>661</sup> Furthermore, in order to determine profit, any related expenditure must be entered in the same period.<sup>662</sup> In this case, a line item known as a transitory item is created which allows for the relevant transaction to be assigned to the correct period.<sup>663</sup> 184

For provisions, this principle means that past events that lead to the expectation of a cash outflow in future financial years – namely, a provision which will probably be required – must be listed in the period they were caused and charged to the profit and loss account.<sup>664</sup> However, according to Art. 960e par. 3 no. 4 CO, provisions are formed in a good period in order to secure the long-term prosperity of the entity and, like cookie jar reserves, dissolved in “a rainy period”.<sup>665</sup> When a provision is retained for longer than needed and not released, it becomes a hidden reserve<sup>666</sup> and forbidden accumulation of 185

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<sup>658</sup> Art. 958a par. 2 CO; Cf. BOEMLE/LUTZ, par. 267.

<sup>659</sup> WIRZ, par. 196.

<sup>660</sup> MERKT, Rechnungslegung, § 1 par. 216.

<sup>661</sup> HANDSCHIN, Rechnungslegungsrecht, par. 317 et seq.

<sup>662</sup> This distinction is especially necessary when interrelated business transactions require more than one accounting transaction, as is the case when delivery and payment are not completed at the same time. HANDSCHIN, Rechnungslegungsrecht, par. 318 seqq.

<sup>663</sup> BÖCKLI, Rechnungslegungsrecht, par. 136. Transitory items exist in the form of both expenditure paid in advance as well as income received in advance. For an overview: HANDSCHIN, Rechnungslegung, par. 320.

<sup>664</sup> Art. 960e par. 2 CO; JUNG, Gesellschaftsrecht, par. 104.

<sup>665</sup> This practice is explicitly allowed. Cf. RIEDERER, par. 134.

<sup>666</sup> HANDSCHIN, Rechnungslegung, par. 889a, as it is mandatory to disclose the late dissolution of the provision, and therefore it is possible to recognise it as dissolution of a provision of a prior period. FONTANA/HANDSCHIN, par. 654.

profit.<sup>667</sup> Thus, the release of provisions, as reserves for future liabilities,<sup>668</sup> can only be reported in the current period when the reason for their creation is no longer applicable in the same period.<sup>669</sup> In contrast, reserves usually do not affect the profit and loss account. Their creation in one period and dissolution in another is not at the discretion of the entity but must follow rules or requirements that must be transparently stipulated in the articles of association.

- 186 It is noteworthy that small companies<sup>670</sup> are exempted from the chronological distinction when their income or the value of their sale of goods or services does not exceed 100,000 CHF.<sup>671</sup>

### (3) Prudence

- 187 The notion of prudence is firmly anchored in the Swiss Code of Obligations in Art. 958c par. 1 no. 5 CO as the other recognised financial reporting principle, as well as for a second time in Art. 960 par. 2 CO as a valuation rule.<sup>672</sup> Prudence must thus be understood mainly as a valuation rule rather than only as a principle.<sup>673</sup> The prudence principle was integrated into the CO in 1991.<sup>674</sup> The key discussion in this regard was whether it should be integrated only as a valuation rule or also as a principle.<sup>675</sup> Before its integration into the CO, prudence was already recognised as an unwritten but fundamental principle of Swiss financial reporting law.<sup>676</sup>
- 188 As shown in [Paragraph 32](#), this valuation rule – according to which assets must be undervalued and financial liabilities overvalued – is responsible and serves as the basis for hidden reserves. The valuation principles arising from the pru-

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<sup>667</sup> JUNG, Gesellschaftsrecht, par. 104.

<sup>668</sup> HANDSCHIN, Rechnungslegung, par. 765.

<sup>669</sup> Cf. HANDSCHIN, Rechnungslegung, par. 889a.

<sup>670</sup> According to Art. 957 par. 1 CO, sole proprietorships and partnerships which have attained sales revenue of at least 500,000 CHF need only to keep account of their asset position, income and expenditure.

<sup>671</sup> Art. 958b par. 2 CO.

<sup>672</sup> Cf. HANDSCHIN, Rechnungslegungsrecht, par. 343.

<sup>673</sup> Cf. BÖCKLI, Aktienrecht, § 8 par. 122. Also HANDSCHIN, Rechnungslegungsrecht, par. 343.

<sup>674</sup> Art. 662a par. 2 no. 3 CO (1991).

<sup>675</sup> Botschaft 2007, p. 1701 and p. 1710.

<sup>676</sup> For an historic overview: BÖCKLI, Rechnungslegung, p. 167 et seqq.

dence principle are the lowest value principle,<sup>677</sup> the cost value principle,<sup>678</sup> and the revaluation prohibition<sup>679 680</sup>. Additionally, the realisation principle and the imparity principle also arise from the prudence principle.<sup>681</sup> The prudence principle stipulates that profit and income are to be reported only after their realisation, while unforeseeable losses and risks may be reported before the date they occur; thus losses are already reported before their realisation.<sup>682</sup> 960b par. 2 CO allows for an exception to the above-mentioned cost value principle, namely the reporting of profit prior to its realisation.<sup>683</sup> However, when a fluctuation reserve is created, this exception is particularly useful for transparent financial reporting.

### (a) Realisation Principle

Profit and income shall only be reported when their realisation occurs.<sup>684</sup> Considering that assets cannot be valued higher in subsequent valuations than they were in the first valuation at the time of the acquisition, fixed assets such as real estate which increase in value have to be valued below their real value. In so doing, unwanted hidden reserves are created.<sup>685</sup> However, in such cases a revaluation reserve<sup>686</sup> is usually created, which as such is not relevant to profit or loss, and is therefore prudent and reliable, because it amounts to no

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<sup>677</sup> The lowest current assets must be reduced in the subsequent assessment to their lowest possible net market value. BEHR/LEIBFRIED, par. 189 et seqq; BÖCKLI, Aktienrecht, § 8 par. 128; BÖCKLI, Rechnungslegungsrecht, par. 188 and 856; GLANZMANN, Gesellschafts- und Handelsrecht, § 25 par. 154; HANDSCHIN, Rechnungslegung, par. 587; CHK-LIPP, Rechnungslegung, Art. 960c par. 14; MÜLLER/HENRY/BARMETTLER, veb.ch Praxiskommentar, Art. 958c par. 54.

<sup>678</sup> According to the cost value principle, the initial reporting value must not be higher than the costs. BÖCKLI, Rechnungslegung, par. 187 et sqq; BÖCKLI, Aktienrecht, § 8 par. 127.

<sup>679</sup> BÖCKLI, Rechnungslegungsrecht, par. 189 and 857 et seqq.

<sup>680</sup> JUNG, Gesellschaftsrecht, par. 107; MEYER, CONRAD, Finanzielles Rechnungswesen, p. 349; MÜLLER/HENRY/BARMETTLER, veb.ch Kommentar. Art. 958c par. 50 and 54.

<sup>681</sup> BÖCKLI, Aktienrecht, § 8 par. 122, 728 et seqq; BOEMLE/LUTZ, p. 131; OFK-DEKKER, Art. 958c par. 16 et seqq; FORSTMOSER/MEIER-HAYOZ/NOBEL, § 51 par. 43; HANDSCHIN, Rechnungslegung, par. 347; MEYER, CONRAD, Finanzielles Rechnungswesen, p. 349.

<sup>682</sup> BÖCKLI, Aktienrecht, § 8 par. 122 et seqq; BÖCKLI, Rechnungslegung, par. 176-184 et seqq; FORSTMOSER/MEIER/HAYOZ/NOBEL, § 50 par. 231; MÜLLER/HENRY/BARMETTLER, veb.ch Praxiskommentar, Art. 958c par. 50 et seqq; BSK II-NEUHAUS/SUTER, Art. 958b par. 6.

<sup>683</sup> BSK II-NEUHAUS/HAAG, Art. 960b par. 1.

<sup>684</sup> BGE 116 II 533 (with further references).

<sup>685</sup> Cf. Art. 960a par. 2 CO.

<sup>686</sup> See [Paragraph 68 et seqq.](#)

more than the disclosure of hidden reserves.<sup>687</sup> This revaluation, according to Art. 725c revCO (Art. 670 CO), represents an exception to the realisation principle.<sup>688</sup> In the following chapter, it will be shown why this exception is justified.

(b) *Contradiction with Reliable Reporting or the True and Fair View?*

190 On the one hand, the prudence principle seems to be in contradiction with the requirement stipulated in Art. 958 par. 1 CO to provide third parties with reliable financial reports; on the other hand, it also appears to conflict with the option of establishing reserves afforded by Art. 960a par. 4 CO and Art. 960e par. 3 no. 4 CO.<sup>689</sup> However, the prudence principle aims to clarify the intent of Art. 958 par. 1 CO, namely to provide third parties with a reliable picture of financial reports.<sup>690</sup> Ultimately, HANDSCHIN correctly sees no contradiction between the principle of prudence and that of reliable reporting, as long as the higher valuation of fixed assets is made prudently and allows for a reliable assessment of a business's financial position.<sup>691</sup>

191 The prudence principle, which aims to prevent an artificial profit from being reported and distributed, is thus a principle that favours the creditors.<sup>692</sup> In particular, prudent valuation should not prevent – but support – the reliable assessment of an entity's financial position.<sup>693</sup> When revaluation occurs alongside the simultaneous formation of a revaluation reserve, revaluation does not affect the profit and loss account, which is thus protected from distribution: In such cases, this amounts to nothing other than a disclosure of hidden reserves.<sup>694</sup>

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<sup>687</sup> HANDSCHIN, Rechnungslegung, pp 182 et seqq.

<sup>688</sup> Cf. JUNG, Gesellschaftsrecht, par. 107.

<sup>689</sup> Cf. BSK II-NEUHAUS/SUTER, Art. 958c par. 13; Cf. JUNG, Gesellschaftsrecht, par. 108.

<sup>690</sup> BSK II-NEUHAUS/SUTER, Art. 958c par. 14.

<sup>691</sup> HANDSCHIN, Rechnungslegungsrecht, par. 345.

<sup>692</sup> Cf. JUNG, Gesellschaftsrecht, par. 107.

<sup>693</sup> Art. 960 par. 2 CO.

<sup>694</sup> HANDSCHIN, Rechnungslegungsrecht, par. 344 and 618.

A revaluation which contravenes the realisation principle but is combined with the formation of a revaluation reserve is an example of the prudence principle not interfering with a reliable reporting and is based on a true and fair view;<sup>695</sup> only the fact that the revised Code of Obligations still permits to *forego the revaluation reserve* is not prudent.<sup>696</sup> Thus, the formation of a revaluation reserve should be mandatory. The real issue in the CO is the unlimited authorisation that it offers for the formation of hidden reserves.<sup>697</sup> 192

Hence, only at first glance does the CO appear prudence oriented. By contrast, standards such as the Swiss GAAP FER or the IFRS aim for a “true and fair presentation” based on a broader understanding of transparency.<sup>698</sup> The CO, on the other hand, still permits nontransparent reporting. 193

#### (4) Transparency

The following principles are related through having transparency as a goal. Transparency is crucial due to the existing notion of the prudence. 194

##### (a) Reliability, Clarity and Comprehensibility

The principle of reliability according to Art. 958c par. 1 no. 3 CO, as well as the principle of clarity<sup>699</sup> and comprehensibility<sup>700</sup> mentioned in no. 1 are based on transparency.<sup>701</sup> 195

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<sup>695</sup> “True and fair view” is a British term taken from Art. 2.5 of the ancient fourth council directive 78/660/EWG of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies. The corresponding American term is “fair representation”, which was used in the IFRS, IAS 1.15 (2007). See for the actual directive Art. 4.3 of the directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. See also GLANZMANN, *Gesellschafts- und Handelsrecht*, § 25 par. 11.

<sup>696</sup> Cf. HANDSCHIN, *Rechnungslegung*, par. 344, 666 et seqq.

<sup>697</sup> GLANZMANN, *Gesellschafts- und Handelsrecht*, § 15 par. 11.

<sup>698</sup> HANDSCHIN, *Rechnungslegung*, par. 298.

<sup>699</sup> The principle of clarity. See BÖCKLI, *Rechnungslegung*, p. 90 and 159.

<sup>700</sup> The aim of this principle is to ensure the easy understanding of financial reports, although a reasonable base of knowledge is still required. MÜLLER/HENRY/BARMETTLER, *veb.ch Kommentar*, Art. 958c, par. 28.

<sup>701</sup> HANDSCHIN, *Rechnungslegung*, par. 321 et seqq.

- 196 It is important to highlight that the principle of reliability<sup>702</sup> is connected to the aim of financial reporting, namely that the financial position of an entity should be presented in such a manner that third parties can make a reliable assessment thereof.<sup>703</sup> Reliability also requires that the financial position should be reported truthfully and that the balance sheet should not be arbitrary.<sup>704</sup> In other words, the information presented must be free from errors and distortions.<sup>705</sup> In order to achieve this, the financial results as well as the process that gives rise to these results must be faultless.<sup>706</sup> This process is protected by criminal law to ensure that investors are presented with truthful information.<sup>707</sup>
- 197 Nevertheless, the principle of transparency is itself restricted by norms relating to the formation and dissolution of reserves, since it is not mandatory by law that provisions which are no longer required must be dissolved.<sup>708</sup> As such, the CO is not primarily concerned with transparency even though the principle of transparency is anchored therein as an important aim.<sup>709</sup> However, the real issue with the CO is the almost unlimited opportunity it presents for the formation of hidden reserves, which is neither compatible with a true and fair view<sup>710</sup> nor with the fundamental principle of transparency.
- 198 Reserves, as described in [Paragraph 28](#), are permitted by the current CO, a rule which should not be rejected because reserves are a useful instrument for protecting and strengthening equity, a goal which is anchored in the CO.<sup>711</sup>

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<sup>702</sup> This term is not identical to “true and fair” according to the prevailing doctrine, HWP, p. 104 et seqq; Botschaft 2007, pp 1625 et seqq, 1699; BÖCKLI, Aktienrecht, § 8 par. 101; BÖCKLI, Rechnungslegung, par. 106, CHK-LIPP, Rechnungslegung, Art. 958 par. 5.

<sup>703</sup> Art. 958 par. 1 CO; BSK II-NEUHAUS/SUTER, Art. 958c par. 9; Botschaft 2007, p. 1701.

<sup>704</sup> HWP, p. 37; BÖCKLI, Rechnungslegung, par. 162.

<sup>705</sup> BÖCKLI, Aktienrecht, § 8 par. 175 et seqq; BÖCKLI, Rechnungslegungsrecht, par. 162 et seqq; HANDSCHIN, Rechnungslegungsrecht, par. 322.

<sup>706</sup> HWP, p. 137 et seqq.

<sup>707</sup> BGE 125 IV 17 consideration. 2.b. See for the forgery of a document BGE 122 IV 25 consideration 2.

<sup>708</sup> Art. 960e par. 4 CO.

<sup>709</sup> HANDSCHIN, Rechnungslegungsrecht, par. 299 et seqq; cf. also CHK-LIPP, Rechnungslegungsrecht Art. 962 par. 3.

<sup>710</sup> GLANZMANN, Gesellschafts- und Handelsrecht, § 25 par. 11.

<sup>711</sup> HANDSCHIN, Rechnungslegungsrecht, par. 890.

As such, reserves themselves are not the problem; instead, it is hidden reserves that represent an example of unacceptable lack of transparency. These should be prohibited and replaced with open and transparent reserves, a concept that already exists and whose use should be promoted.<sup>712</sup> Ultimately, open reserves unite the principle of prudence with those of transparency as well as true and fair view.

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### (b) *Materiality, Completeness and Relevance*

The principles of materiality, completeness and relevance from Art. 958c no. 2 and 4 OR are also based on the principle of transparency.<sup>713</sup> The materiality principle is a long-standing concept which corresponds to the principle of “*minima non curat praetor*”,<sup>714</sup> namely that irrelevant facts do not need to be reported.<sup>715</sup> Material facts are those which affect at least five per cent of the final results.<sup>716</sup> Materiality is thus not a qualitative notion, but its influence is generally important.<sup>717</sup> Failure to adhere to the principle of completeness results in a breach of the transparency principle.<sup>718</sup> In the worst case, not reporting expenditure – and thus falsifying a balance sheet – risks transgressing Art. 251 Penal Code (i.e. forgery of a document).<sup>719</sup> Ultimately, however, the creation of hidden reserves is still permitted by Swiss law,<sup>720</sup> since this was not prohibited in the last revision of the code.<sup>721</sup>

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<sup>712</sup> Cf. HANDSCHIN, Rechnungslegungsrecht, par. 890.

<sup>713</sup> *IBID.*, par. 321 et seqq.

<sup>714</sup> BÖCKLI, Rechnungslegungsrecht, par. 166.

<sup>715</sup> Botschaft 2007, pp 1071-1703.

<sup>716</sup> BSK II-NEUHAUS/SUTER, Art. 958c par. 12.

<sup>717</sup> BÖCKLI, Rechnungslegung, par. 165 et seq.

<sup>718</sup> HANDSCHIN, Rechnungslegungsrecht, par. 321 et seqq.

<sup>719</sup> BGer 6B\_827/2010 of 24/01/2011 consideration 2.3; cf. BÖCKLI, Rechnungslegungsrecht, par. 316 et seqq.

<sup>720</sup> Cf. BGE 82 II 216; BGE 92 II 243; BGE 110 Ib 127; BÖCKLI, Rechnungslegungsrecht, par. 1083 et seqq.

<sup>721</sup> Revision in 2020. As a result, there remains a discrepancy between the principles of financial reporting and corporate law.

201 The principle of relevance, which can be compared to the well-established principle of true balance sheet,<sup>722</sup> signifies correctness<sup>723</sup> or lack of arbitrariness.<sup>724</sup> The creation and dissolution of hidden reserves also transgress this principle.<sup>725</sup> Apart from this, the principles of materiality, completeness and relevance do not interfere especially with reserves.

(c) Consistency

202 The principle of consistency is referred to in Art. 958c par. 1 no. 6 and also pertains to the articles on transparency.<sup>726</sup> In practical use, the term is often employed as a synonym for “comparability”,<sup>727</sup> but the latter is originally from the anglophone tradition<sup>728</sup> and was ultimately not included in the last revision of the financial reporting law.<sup>729</sup> The reason for this was that the term “comparability” is confusing and can give rise to the wrong impression that, according to the CO, financial reports must be comparable to those of other companies.<sup>730</sup> Comparability is not a goal of the financial reporting law in the CO, especially because the easy creation and dissolution of hidden reserves is ultimately a question of transparency.<sup>731</sup>

203 In contrast, the international regulations do aim for comparability between different companies.<sup>732</sup> Consistency is to be understood as the aim to achieve comparability between an individual company’s different annual financial statements and is thus a dynamic form of evaluation measured over time.<sup>733</sup> It is obligatory that the structure and form of balance sheets, income statements and notes remain the same each year.<sup>734</sup> This allows companies to adapt to new methods of financial reporting without reducing the comparability of their latest reports with their previous annual financial statements.<sup>735</sup> Each variation in

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<sup>722</sup> Art. 959 CO (1936), i.e. *Bilanzwahrheit* in German.

<sup>723</sup> BÖCKLI, Rechnungslegungsrecht, p. 39.

<sup>724</sup> BOEMLE/LUTZ, pp 119 et seqq; cf. HWP, p. 20.

<sup>725</sup> BÖCKLI, par. 162 et seqq.

<sup>726</sup> HANDSCHIN, Rechnungslegung, par. 334 et seq.

<sup>727</sup> HANDSCHIN, Rechnungslegung, par. 329 et seq.

<sup>728</sup> IFRS, Conceptual Framework, QC 20 et seqq.

<sup>729</sup> It is, however, still mentioned in the papers. Botschaft 2007, p. 1702.

<sup>730</sup> Botschaft 2007, p. 1702.

<sup>731</sup> HANDSCHIN, Rechnungslegung, p. 177.

<sup>732</sup> IAS 8.1; HANDSCHIN, Rechnungslegung, par. 327 et seqq.

<sup>733</sup> HANDSCHIN, Rechnungslegung, par. 337 et seqq.

<sup>734</sup> Botschaft 2007, p. 1702.

<sup>735</sup> HANDSCHIN, Gesellschaftsrecht, pp 327 et seqq.



the reporting methods which could affect consistency should be listed in the notes.<sup>736</sup> As such, the consistency principle is more aptly described by the term “comparability”, i.e. comparability with the other financial reports produced by the same company.<sup>737</sup>

This principal of consistency is crucial if different valuations are possible, such as may be the case for assets with a stock exchange price or another observable market price in an active market according to Art. 960 par. 1 CO: Once a valuation method is selected, it should be maintained in order to comply with the principle of consistency.<sup>738</sup> 204

Thus, the principle of consistency affects the formation of fluctuation reserves only indirectly. When valuation becomes very nontransparent, fluctuation reserves cannot be used in the genuine sense of the term, which would require a combination of simultaneous transparency and prudence. 205

Furthermore, the disclosure of hidden reserves, as stipulated in Art. 959c par. 1 no. 3 CO, is pointless if the reporting is not consistent; otherwise, an enterprise can easily conceal a disadvantageous financial situation, as will be explained in the next chapter. 206

#### (d) *Offsetting Proscription*

The last principle based on transparency, stipulated in Art. 958c no. 7 CO, is self-explanatory, and thus a genuine norm.<sup>739</sup> In principle, the offsetting of assets against liabilities as well as the offsetting of expenditure and liabilities are not permitted.<sup>740</sup> This proscription refers to both horizontal offsetting as well as vertical balancing.<sup>741</sup> The minimal structure stipulated in Art. 959a CO (balance sheet) and Art. 959b CO (profit and loss account) is mandatory; hence the mentioned items must be reported “individually”; this minimal structure thus already implies a proscription on offsetting.<sup>742</sup> 207

<sup>736</sup> BOEMLE/LUTZ, p. 446.

<sup>737</sup> HANDSCHIN, par. 929 et seqq.

<sup>738</sup> Cf. BSK II-NEUHAUS/ HAAG, Art. 960b par. 16.

<sup>739</sup> Botschaft 2007, p. 1702.

<sup>740</sup> Art. 662a par. 2 no. 6 CO (2011); BOEMLE/LUTZ, pp 124 et seq.

<sup>741</sup> BÖCKLI, Rechnungslegung, par. 201 et seqq.

<sup>742</sup> HANDSCHIN, Rechnungslegungsrecht, par. 337 et seqq, BÖCKLI, Rechnungslegung, par. 201 et seqq.

- 208 However, according to the CO of 2007, an exception to this principle was possible as long as it was explained in the notes.<sup>743</sup> Although this exception was removed, the idea was not for an absolute proscription, but rather to ensure that the clarity and the understandability of the reporting was not negatively affected.<sup>744</sup> Nevertheless, the removal was combined with the declaration that some extraordinary situations can be exempted from this regulation, a decision which has been heavily criticized by BÖCKLI.<sup>745</sup> The prohibition to offset is thus not an absolute prohibition.<sup>746</sup>
- 209 Moreover, the Swiss GAAP FER permits exceptions to the offsetting prohibition as long as transparency is still guaranteed and the true financial state of the enterprise remains clear.<sup>747</sup>
- 210 The CO demands disclosure in the notes to the annual accounts of the total value of the replacement reserves used and of any additional hidden reserves if together they exceed the total value of new reserves of the same type and the result thereof is considerably more favourable.<sup>748</sup> An entity is thus only obligated to disclose the net or balanced result in violating the offsetting proscription.<sup>749</sup> Correctly, disclosure should occur for all newly formed hidden reserves, and their disclosure should – due to their different function and use – be separate from that of earlier dissolved hidden reserves.<sup>750</sup>
- 211 The aim here is to prevent the hidden dissolution of hidden reserves in order to present an artificially healthy financial situation due only to the dissolution of hidden reserves. Consequently, all information on the netted, dissolved and newly formed hidden reserves must be reported.<sup>751</sup> According to the CO of 1991, the board of directors was legally obligated to report each individual formation and dissolution of hidden reserves.<sup>752</sup> In contrast, the offsetting of open reserves is clearly proscribed.

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<sup>743</sup> Art. 662a par. 3 CO (1991). Offsetting according to Art. 120 CO is allowed because by its nature it does not breach this rule.

<sup>744</sup> Botschaft 2007, p. 1702.

<sup>745</sup> A clear rule by the Parliament would be the right way. BÖCKLI, Rechnungslegungsrecht, par. 217.

<sup>746</sup> BSK OR II-NEUHAUS/GERBER, Art. 959c par. 12.

<sup>747</sup> Swiss GAAP FER Rahmenkonzept Cl. 14.

<sup>748</sup> Art. 959c par. 1 no. 3 CO.

<sup>749</sup> HANDSCHIN, Rechnungslegung, par. 882 and 887.

<sup>750</sup> *Ibid.*, par. 882.

<sup>751</sup> *Ibid.* See also BÖCKLI, Rechnungslegung, par. 1116; BÖCKLI, Aktienrecht, § 8, par. 910.

<sup>752</sup> Art. 669 par. 4 CO (1991). Since 2011 this possibility is no longer mentioned.

The CO stipulates in the revised legislation that the offsetting of annual losses with reserves must occur in a strict order: first, with the retained earnings (no. 1); second, with the voluntary retained earnings reserve<sup>753</sup> (no. 2); third, with the legal retained earnings reserves<sup>754</sup> (no. 3); and, finally, with the legal capital reserves (no. 4).<sup>755</sup> This form of offsetting serves to bring more clarity and understandability to the reporting, and thus complies with this principle, the offsetting proscription.<sup>756</sup> 212

## 3.2. Specific Financial Markets Regulations

### 3.2.1. Financial and Regulatory Auditing

The supervision of banks is a dual process that comprises both a financial and regulatory audit: The Federal Audit Supervision Authority (RAB) is responsible for the financial audit while the Swiss Financial Market Supervisory Authority (FINMA) is responsible for regulatory supervision.<sup>757</sup> FINMA may conduct direct audits of banks, banking groups and financial conglomerates only if this is necessary in view of the bank's economic significance, the complexity of the factors to be addressed or its approval of internal models.<sup>758</sup> Direct audits are otherwise carried out by an approved audit company whose audit and financial supervision is conducted under the auspices of the Federal Audit Supervision Authority,<sup>759</sup> not FINMA.<sup>760</sup> 213

The main goal of financial market supervision is to guarantee the functionality of the financial market, including the protection of individual market participants as well as of the system as a whole, and to ensure transparency of information, equal treatment, competition and liquidity.<sup>761</sup> The protection of the system, in particular, is aimed at strengthening the stability of the financial 214

<sup>753</sup> Or voluntary profit reserve. See overview, [Paragraph 154](#).

<sup>754</sup> Or legal profit reserve. See overview, [Paragraph 154](#).

<sup>755</sup> Art. 674 revCO.

<sup>756</sup> Art. 958c par. 1 no. 1 CO; See also the comment on Art. 674 revCO, Botschaft 2016, p. 525.

<sup>757</sup> See NOBEL, Finanzmarkt, § 7, par. 3 et seqq and 47 for criticisms of and changes to this dual system; see also KUNZ, Kreuzfahrt, p. 44. In case of a consolidated supervision, FINMA in particular shall review whether the financial group applies the accounting regulations correctly as per Art. 24 par. 1 lit. h BankV.

<sup>758</sup> Art. 23 BankG; cf. NOBEL, Finanzmarkt, § 7, par. 3.

<sup>759</sup> RAB, Eidgenössische Revisionsaufsichtsbehörde.

<sup>760</sup> Art. 18 BankG.

<sup>761</sup> NOBEL, Finanzmarktrecht, § 1, par. 136 et seqq and § 7, par. 9.

sector and is grounded in key variables like higher equity requirements, stricter liquidity requirements, more effective risk distribution and organisational structures, as well as the creation of capital reserves and conversion capital.<sup>762</sup>

(1) *Financial Market Regulation*

215 The regulation of Swiss financial markets can be illustrated as a house of Regulation, in which the Financial Market Supervision Act (FINMAG) lies at the centre.<sup>763</sup> The Federal Act of Banks and Savings Banks is one of the eight acts that comprises this financial market regulation.<sup>764</sup> The financial Accounting regulation for banking and securities dealers is composed of a hierarchy of regulations in the Federal Act of Banks and Savings Banks and its Ordinance on Banking and Savings Banks as well as in FINMA's Circular FINMA-RS 2020/1 and its new Financial Accounting Ordinance.<sup>765</sup> Generally, the financial accounting rules for banking differ from the accounting rules for the non-banking sector through their very detailed rules, lack of case law, and fast-growing and dynamic nature.<sup>766</sup> The Financial Accounting Regulations for Banking and Securities Dealers as well as the Capital Adequacy Ordinance and Liquidity Ordinance regulate the creation and the use reserves. These rules will be discussed below.

(a) *The House of Regulation*

(i) *The Banking Act*

(a) Legal Nature

216 As public law, the Banking Act regulates the relationship between the state and private persons; in a conflict between private and public law, the latter has priority.<sup>767</sup> At first glance, the purpose of the Banking Act is to protect clients –

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<sup>762</sup> See Art. 7-13 BankG; NOBEL, *Finanzmarktrecht*, § 7, par. 9.

<sup>763</sup> Cf. JANS/LENGWILER/PASSARDI, p. 53; cf. NOBEL, *Finanzmarktrecht*, § 5 par. 101; KUNZ, *Kreuzfahrt*, pp 29 et seq.

<sup>764</sup> For the other financial market acts, see Art. 1 FINMAG.

<sup>765</sup> Cf. RIEDER/SUCHET, ST 2014/8 p. 594.

<sup>766</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 54; cf. NOBEL, *Finanzmarktrecht*, § 7, par. 1 and 7.

<sup>767</sup> ABEGG/GEISSBÜHLER/HAEFELI/HUGGENBERGER/LARUMBE, p. 349.

and thus creditors<sup>768</sup> – but it also ensures that the Swiss financial industry as a whole is regulated and remains stable for the sake of the public interest.<sup>769</sup> The legislative technique used for this purpose is that of framework legislation, which due to its generally abstract nature – which only stipulates basic principles and mandatory requirements – needs to be supplemented with an ordinance.<sup>770</sup> This need for further specification shifts authority from the legislative branch to the executive.<sup>771</sup>

### (b) Scope of Application

On the one hand, the nature of reserves means that not all reserves are applicable to the banking sector; on the other hand, special reserves – such as the reserves for general banking risks – are only applicable to the banking sector. The material and territorial scope of application of the term “bank” will be discussed below. 217

#### (i) The Material Scope of Application of the Term “Bank”

The subject of the Banking Act and the financial sector are banks,<sup>772</sup> private banks<sup>773</sup> and savings banks.<sup>774, 775</sup> Not considered as banks are corporations and institutions under public law as well as savings institutions that accept deposits from the public on a commercial basis.<sup>776</sup> Companies are considered to be banks if they are mainly active in the financial sector and accept deposits 218

<sup>768</sup> Historically, this was the only purpose, Botschaft 1970, p. 1145.

<sup>769</sup> Cf. ABEGG/GEISSBÜHLER/HAEFELI/HUGGENBERGER/LARUMBE, p. 348; cf. NOBEL, Finanzmarktrecht, § 7, par. 23; BGE 111 Ib 127; cf. BSK BankG-BERNET/PORTMANN, Art. 6/6a/6b, par. 1 and 3.

<sup>770</sup> NOBEL, Finanzmarktrecht, § 1, par. 133 et seq and § 7, par. 23.

<sup>771</sup> Ibid.

<sup>772</sup> As of 2020, 290 banks and securities firms have been officially authorized as banks, <https://www.finma.ch/de/finma-public/bewilligte-institute-personen-und-produkte/> (last accessed: 15/01/2021).

<sup>773</sup> Private banks are a privileged type of bank that are legally recognised as sole proprietorships or general or limited partnerships. Cf. NOBEL, Finanzmarktrecht, § 7, par. 208 et seq.

<sup>774</sup> Saving banks as such do not exist anymore. ARPAGAUS/STADLER/WERLEN, par. 12.

<sup>775</sup> Art. 1 par. 1 BankG.

<sup>776</sup> Art. 3 BankV.

from the public or publicly advertise doing so.<sup>777</sup> However, stockbrokers and trading houses that deal only in securities and other directly related business transactions as well as asset managers, notaries, and businesses which simply manage their customers' funds without engaging in regular banking business are not included under the scope of application of the Banking Act.<sup>778</sup> These so-called para-banking activities are bank-like, but the banking regulations do not apply for what are known as para-banks or shadow banks.<sup>779</sup> As a general rule, a deposit is not considered as such when no interest is paid on it.<sup>780</sup> The same applies to deposited funds that arise from a contract for the transfer of ownership or from the rendering of a service or to funds which are transferred as securities.<sup>781</sup> The accounting rules for banking are also not applicable to the Swiss National Bank or to central mortgage institutions.<sup>782</sup> Finally, the name "bank" or "banker" may only be used if the entity has obtained a license from FINMA.<sup>783</sup> Thus, all banks – independent from the legal form by which they are organised – are subject to the Banking Act.<sup>784</sup> The easements or exception in Art. 6a par. 3 Banking Act apply only to private bankers, which do not publicly recommend accepting foreign funds.<sup>785</sup>

#### (ii) Financial Institutions as Securities Firms

- 219 By analogy, the Banking Act applies equally to securities firms.<sup>786</sup> Thus, the scope of application is extended. Consequently, the accounting rules are ap-

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<sup>777</sup> Being active in the financial sector is defined as rendering financial services, especially operating deposit and credit facilities as well as securities trading and investment services; also covered under this definition are institutions that own qualifying equity interests in companies that are mainly active in the financial sector. Art. 4 par. 1 BankV.

<sup>778</sup> Art. 1 par. 3 BankG.

<sup>779</sup> Cf. NOBEL, Finanzmarktrecht, § 7, par. 312 et seqq.

<sup>780</sup> Art. 5 par. 3 lit. c BankV; cf. FINMA, Jahresbericht 2009, pp 46 ; also NOBEL, Finanzmarktrecht, § 7, par. 123.

<sup>781</sup> Art. 5 par. 3 lit. a BankV. There is much case law that does not allow for this exception and by which such funds are classified as deposits; see BGVer B-4354/2016 of the 30/11/2017 consideration 5.2.1.1; see also SCHÖNKNECHT, GesKR 2016 pp 316 et seq; for more cases, see NOBEL, Finanzmarktrecht, § 7, par. 118.

<sup>782</sup> They are applicable, however, if this is explicitly stated; Art. 1 par. 5 BankG.

<sup>783</sup> Art. 1 par. 4 BankG.

<sup>784</sup> Art. 1 par. 1 and Art. 6a par. 3 BankG; BSK BankG-BERNET/PORTMANN, Art. 6/6a/6b, par. 80.

<sup>785</sup> Art. 1 par. 1 and Art. 6a par. 3 BankG; BSK BankG-BERNET/PORTMANN, Art. 6/6a/6b, par. 80.

<sup>786</sup> Art. 2 par. 2 and 48 FINIG; see also BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 49 with further references to the former Art. 10 BEHG.

plicable to all securities firms – and, as such, also to reserves for general banking risks. However, as the term “banking” describes the function of a bank, this must match with the above-described definition of a bank.

### (c) Territorial Scope

The territorial scope of application of the accounting rules for banking extends to established branches of foreign banks in Switzerland as well as to representatives of foreign banks in Switzerland;<sup>787</sup> it is thus sufficient when a company operates on Swiss territory.<sup>788</sup> When a banking entity’s headquarters are domiciled in Switzerland, its activities in foreign territories are also subject to the Banking Act.<sup>789</sup> This is based on the principle that any banking activity organised from Swiss territory is regarded as occurring in Switzerland.<sup>790</sup> As such, nominated representatives as well as affiliate companies fall under the scope of application of the Banking Act.<sup>791</sup> 220

### (d) Applicability of the CO’s Accounting Principles

Art. 6 par. 3 Banking Act refers to the applicability of the accounting principles outlined in the CO for banking accounting.<sup>792</sup> The principles explained in [Paragraph 177](#) also apply to banking accounting. They constitute a form of minimum standard, from which the banking-sector can deviate when specific needs arise – such as in relation to structure – or when stricter rules apply.<sup>793</sup> 221

<sup>787</sup> Art. 2 par. 1 BankG; see also Art. 3 par. 2 and 8 FINMA-Circ 2020/1.

<sup>788</sup> RIMLE, § 1 par. 35 et seq.; WYSS/ZULAUF, *Fiktiver Sitz oder faktische Zweigniederlassung?*, p. 123.

<sup>789</sup> RIMLE, § 1 par. 35 et seq.; WYSS/ZULAUF, *Fiktiver Sitz oder faktische Zweigniederlassung?*, p. 123; NOBEL, *Finanzmarktrecht*, § 7, par. 277. See Art. 154 par. 2 IPRG, which states that a subsidiary of a company shall be subject to the law of the state in which it is actually managed.

<sup>790</sup> BGE 105 Ib 348.

<sup>791</sup> BGE 130 II 351 consideration 5.1; WYSS/ZULAUF, *Fiktiver Sitz oder faktische Zweigniederlassung?*, pp 134 et seqq; NOBEL, *Finanzmarktrecht*, § 7, par. 269.

<sup>792</sup> BSK BankG-BERNET/PORTMANN, Art. 6/6a/6b, par. 6. In addition to this general referral, they are reformulated in the Banking Ordinance in Art. 25-42 BankV. See also NOBEL, *Finanzmarktrecht*, § 7 par. 45. Especially see Art. 26 par. 2 BankV without a referral to the BankG or CO’s principles.

<sup>793</sup> Cf. BSK BankG-BERNET/PORTMANN, Art. 6/6a/6b, par. 6.

(e) Deviations from the CO

222 The Federal Council may deviate from the CO if justified by the specific circumstances of a banking business or the protection of its creditors and its financial situation is presented in an equivalent manner.<sup>794</sup> The Federal Council may also give FINMA the competence to issue limited provisions relating to technical matters, including clarifications to the accounting, valuation and structural norms.<sup>795</sup> Such a deviation based on the specific needs of the banking-sector as well as the protection of creditors could take the form, for example, of general banking risks that appear on the balance sheet. However, the applicability of some reserves is restricted in the financial sector. Fluctuation reserves and revaluation reserves are effectively not applicable in the financial sector. Although, unlike the previous circular, the current circular does not ban these completely, it does not aim to make any substantive changes.<sup>796</sup> Equally, the new ordinance is not meant to make any changes to the existing law, but instead to clarify it.<sup>797</sup> Restrictions also apply to hidden reserves in the financial sector.<sup>798</sup>

(ii) *Banking Ordinance*

223 The Federal Council's Banking Ordinance is the second source of regulations for banking accounting.<sup>799</sup> The advantage of having these regulations contained in an ordinance is that an act takes strict precedence over an ordinance; thus, any conflicts with the CO's banking accounting are already resolved in the Banking Ordinance.<sup>800</sup> In any case, contracting rules are not covered by the delegated competences in Art. 6b Banking Act, and would therefore not be valid.<sup>801</sup> The Banking Ordinance includes the right to choose between the different types of financial statements.<sup>802</sup> Although the Banking Act already mentions the applicability of the CO's financial accounting rules, the Banking Or-

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<sup>794</sup> Art. 6b par. 2 BankG; Botschaft 2008, p. 1742.

<sup>795</sup> Art. 6b par. 3 BankG; Botschaft 2008 p. 1743.

<sup>796</sup> Cf. FINMA's Press Release of 14 November 2019, see <https://www.finma.ch/de/news/2019/11/20191114-mm-rechnungslegung/> (last accessed: 15/01/2021).

<sup>797</sup> Ibid.

<sup>798</sup> Ibid.

<sup>799</sup> Based on the statutory authorization in Art. 6b par. 1 BankG; BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 10.

<sup>800</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 10.

<sup>801</sup> Ibid.

<sup>802</sup> Art. 25 par. 1 lit. a and b BankV.



dinance explicitly mentions each of the principles that must be observed by the financial statements.<sup>803</sup> The Banking Ordinance further states that the basic structure and notes of the balance sheet must be much more detailed than the equivalent in the non-banking sector, therefore the balance sheet as well as the profit and loss account contain an item that is not applicable in the non-banking sector – reserves for general banking risks.<sup>804</sup> These were previously mentioned in the Banking Ordinance before being transferred to the notes on basic structure.<sup>805</sup> Currently, reserves for general banking risks are primarily regulated by both the FINMA Circular and the Banking Ordinance,<sup>806</sup> since mentioning these reserves only in the Banking Ordinance could be insufficient in light of the delegation norm<sup>807,808</sup>. Since reserves for general banking risks lead to a reduction in the profit available for the payment of dividends and are therefore under the authority of the general assembly, there is a legal basis for this fundamental transfer of competence.<sup>809</sup> However, reserves for general banking risks are very similar in nature to hidden reserves due to the authority enjoyed by the board to create and dissolve them. Consequently, to the extent that reserves for general banking risks cover the hidden reserves or are disclosed as being hidden reserves – whose creation and release are under the authority of the board of directors – no transfer of competence has taken place.

### (iii) *Standards Issued by FINMA*

In its role as the accounting standard setter for banks, FINMA issues standards.<sup>810</sup> As they are issued by the same authority that is responsible for the supervision of banks, it gives these standards a normative power.<sup>811</sup> In 2020 the

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<sup>803</sup> Art. 26 par. 1 and 2 BankV. See also BSK BankG-BERNET/PORTMANN, Art. 6/6a/6b, par. 81 et seqq and par. 147. Additionally, the Banking Ordinance mentions the principle of substance over form, according to which the financial perspective prevails over the legal perspective. GMÜR, *Krisenfeste Schweizer Banken?*, p. 156. See [Paragraph 177](#) for the principles stipulated in the CO and their impact on reserves.

<sup>804</sup> Notes 1 A. 2 and B and E to the BankV; cf. BSK BankG-BERNET/PORTMANN, Art. 6/6a/6b, par. 18.

<sup>805</sup> Note 1 to the BankV of 13 April 2014; BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 10.

<sup>806</sup> See Art. 46 and 59 RelV-FINMA; FINMA-Circ 2020/1, par. 33-36.

<sup>807</sup> Art. 6b BankG; Art. 62 FINIG.

<sup>808</sup> Cf. BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 13.

<sup>809</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 14.

<sup>810</sup> See Art. 7 Abs. 1 FINMAG.

<sup>811</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 11.

previous circular (2015/01) on banking accounting was replaced with a streamlined ordinance, Rel-FINMA,<sup>812</sup> and a principles-based circular (2020/01).<sup>813</sup>

(a) FINMA-Circular 2020/01

- 225 The new circular sets out FINMA's practice on accounting issues with a substantially more streamlined and clear set of rules, while the new ordinance contains the fundamental provisions on valuations and recognition.<sup>814</sup> A new approach to creating value adjustments for default risks for non-impaired receivables is also included in the Circular.<sup>815</sup> This states that when the release of the adjustments for default risk that affect the profit and loss account is waived, the adjustments represent hidden reserves that are changed to the status of provisions or reserves for general banking risks.<sup>816</sup> This change must be disclosed under the Position 16: Presentation of value adjustments, provisions, reserves for general banking risks and changes therein during the current year.<sup>817</sup>
- 226 The circular regulates the creation, release and reporting of reserves for general banking risks.<sup>818</sup> Reserves for general banking risks must be listed in the equity statement in the following position: share capital, capital reserves, retained earnings reserves, reserves for general banking risks, voluntary earnings reserves and accumulated retained earnings or losses, negative reserves

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<sup>812</sup> Based on Art. 3g, 6b par. 3 and 4 BankG; Art. 27 par. 1, Art. 31 par. 2, Art. 32 par. 2, Art. 35 par. 4, Art. 36 par. 3, Art. 37 and Art. 42 BankV; and Art. 48 FINIG.

<sup>813</sup> FINMA's Press Release of 14 November 2019, see <https://www.finma.ch/de/news/2019/11/20191114-mm-rechnungslegung/> (last accessed: 15/01/2021).

<sup>814</sup> Cf. FINMA's Press Release of 18 March 2019, see <https://www.finma.ch/de/news/2019/11/20191114-mm-rechnungslegung/> (last accessed: 15/01/2021).

<sup>815</sup> The notion of eliminating the risk of a procyclical effect arising from valuation adjustments being created too late is derived from international accounting standards. In comparison, the Swiss solution is significantly simpler and more principles-based. FINMA's Press Release of 18 March 2019, see <https://www.finma.ch/de/news/2019/11/20191114-mm-rechnungslegung/> (last accessed: 15/01/2021); see also Erläuterungsbericht 19/03/2019, p. 10.

<sup>816</sup> FINMA-Circ 2020/1, par. 31.

<sup>817</sup> Notes to FINMA-Circ 2020/1.

<sup>818</sup> FINMA-Circ 2020/1, par. 33 et seqq.

for the company's own contributions, and the period's profit.<sup>819</sup> Furthermore, if the company is preparing a cash flow statement, any changes to the general banking risks are disclosed under the operating activities.<sup>820</sup>

(b) ReIV-FINMA

As mentioned above, the new ordinance contains the fundamental provisions on valuation and recognition. In relation to general banking reserves, the ordinance provides details on the impact of rebooking on the profit and loss account. The differentiation between reliable assessment statutory single-entity financial statements and true and fair view single-entity financial statements is new.<sup>821</sup> In both types of statements, however, the effect is the same: since rebooking is not a neutral process, it has an impact on the profit and loss account. As such, in order to optimize the use of reserves for general banking risks, the same rules should apply to both types of statements. Finally, deferred taxes must be taken into account when calculating the existing value of and making allocations to reserves for general banking risks.<sup>822</sup> The question of when expenses should be recognised for tax purposes – in other words, when to deduct expenses from taxable income – is important in practice, because as long as there is no financial advantage to be gained there is no reason to favour reserves for general banking risks over more opaque arbitrary hidden reserves.<sup>823</sup>

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<sup>819</sup> Note 3 to FINMA-Circ 2020/1. See also Note 3 for additional information on consolidated companies.

<sup>820</sup> Note 5 to FINMA-Circ 2020/1.

<sup>821</sup> For reliable assessment statutory single-entity financial statements, the formation may affect the profit and loss account, but this is always the case for true and fair view single-entity financial statements; Art. 46 and 59 ReIV-FINMA.

<sup>822</sup> Only for reliable assessment statutory single-entity financial statements. See Art. 59 par. 2 CO.

<sup>823</sup> HANDSCHIN, Rechnungslegung, par. 844.

(iv) *(Equity and Liquidity Adequacy Requirements)*

228 In contrast to entities in the non-banking sector, banks must have adequate capital and liquidity.<sup>824</sup> For banks, a strict equity-based regulation applies due to the banking sector's central economic relevance and importance.<sup>825</sup> The equity or capital adequacy requirement is especially significant in relation to reserves.<sup>826</sup> The Banking Act as well as the following sources contain regulations relating to reserves.

(a) Basel I-III

229 The non-binding international standards Basel I-III aim to eliminate variations between different sets of national regulations<sup>827</sup> and to raise levels of equity or own funds to better compensate for losses.<sup>828</sup> The Basel standards comprise three pillars: minimum equity requirements and risk requirements; supervision of equity backing and risk management; and transparency through disclosure.<sup>829</sup> In Switzerland, the Basel standards are enacted through the Equity Adequacy Ordinance and a FINMA circular.<sup>830</sup> The rules on liquidity have been adopted without alteration, but the rules on equity are stricter. The so-called "Swiss Finish" thus constitutes a series of additional rules.<sup>831</sup>

(b) Rules on Own Capital Requirements

230 In contrast to the non-financial sector, the rules on own capital or own funds are regulated to a very high degree and are therefore highly complex.<sup>832</sup> The usual means of measuring the proportion of capital and debt – the debt-to-

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<sup>824</sup> Art. 4 par. 1 BankG; according to Art. 3 par. 2 lit. b BankG in conjunction with Art. 15 par. 1 BankV, minimum capital must be at least 10 million; NOBEL, Finanzmarktrecht, § 8, par. 194 et seqq.

<sup>825</sup> Cf. ARPAGAU/STADLER/WERLEN, par. 2872; cf. BSK BankG-BINGERT/HEINEMANN, Art. 4, par. 2.

<sup>826</sup> BSK BankG-BERNET/PORTMANN, Art. 6/6a/6b par. 373.

<sup>827</sup> NOBEL, Finanzmarktrecht, § 7, par. 621.

<sup>828</sup> ABBEGG/MOSER, Finanzmarktrecht, par. 271 et seqq.

<sup>829</sup> NOBEL, Finanzmarktrecht, par. 628 et seqq; ARPAGAU/STADLER/WERLEN, par. 2845 et seqq.

<sup>830</sup> Cf. [www.finma.ch](http://www.finma.ch) (last accessed: 15/01/2021); NOBEL, Finanzmarktrecht, § 7, par. 626.

<sup>831</sup> Art. 45 ERV; cf. NOBEL, Finanzmarktrecht, § 7, par. 627; EFD, Kurzbericht über die Anhörung zur Änderung der Eigenmittelverordnung, Bern, 2012, p. 4. See NOBEL, Finanzmarktrecht, § 7, par. 630 for a diagram that illustrates these differences.

<sup>832</sup> NOBEL, Finanzmarktrecht, § 7, par. 646; KUNZ, Kreuzfahrt, p. 139.

capital ratio – is not used.<sup>833</sup> Banks must hold adequate capital to cover any credit risk, market risk, non-counterparty risk and/or operational risk to which they are exposed.<sup>834</sup> Additionally, banks must differentiate between effective equity<sup>835</sup> and eligible equity,<sup>836</sup> because the banking supervision rules dictate that some equity components cannot be charged to the eligible equity.<sup>837</sup> Open reserves, including reserves for general banking risks, are common equity<sup>838</sup> and thus increase the eligible equity. In banks that are organised as cooperatives, cooperative capital can only be counted as common equity if the bank is allowed to reject the repayment of cooperative shares.<sup>839</sup>

Rating agencies<sup>840</sup> exist to measure capital in relation to credit and market risks;<sup>841</sup> nonetheless, individual companies are responsible for assessing and limiting their own risks independently, and there is thus no legal basis for constant supervision by the rating agencies.<sup>842</sup> Banks must prove to the Swiss Central Bank on a quarterly basis that they have adequate capital.<sup>843</sup>

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<sup>833</sup> NOBEL, *Finanzmarktrecht*, § 7, par. 647; BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 21. As traditionally calculated in the non-financial sector, equity is the difference between the assets and the debt capital; TAISCH, § 2, par. 91; cf. BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 21. Equity thus acts as a buffer; ARTER/FEDERLE, p. 74.

<sup>834</sup> Art. 1 par. 2 ERV; see BSK BankG-BINGERT/HEINEMANN, Art. 4, part. 1.

<sup>835</sup> Effective equity refers to the method used in the non-banking sector. In the banking sector, this measurement is comparable to the leverage ratio used for systemically important banks. BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 21.

<sup>836</sup> Composed of Tier-1-Capital, T1, Art. 18 ERV (Common Equity Tier 1, CET 1, Art. 21 et seqq ERV, Additional Tier 1, AT1, Art. 27 et seqq ERV) and Supplementary Capital Tier-2-Capital, T2, Art. 30 et seqq ERV.

<sup>837</sup> ARPAGAUS/STADLER/WERLEN, par. 2876 et seq and 2907 et seqq.

<sup>838</sup> Tier 1 or CET1; Art. 21 lit. b and c. ERV; BSK BankG-BINGERT/HEINEMANN, Art. 4, par. 22.

<sup>839</sup> BSK BankG-BINGERT/HEINEMANN, Art. 4, par. 25 and 30. For cantonal banks or public banks, government guarantees do not count as equity, since Art. 20 par. 1 ERV requires equity to have already been paid in.

<sup>840</sup> ARPAGAUS/STADLER/WERLEN, par. 2937 et seqq; See <https://finma.ch/de/bewilligung/ratingagenturen/>; FINMA-Circular 2012/1; for an illustration of the criteria used by Standard & Poor's Ratings Services (last accessed: 15/01/2021); see Emch/Renz/ARPAGAUS, par. 2860.

<sup>841</sup> Art. 6 ERV.

<sup>842</sup> FINMA-Circ 12/1, par. 7.

<sup>843</sup> This only applies on a biannual basis for consolidated financial statements. Art. 14 ERV.

232 Furthermore, the eligible equity<sup>844</sup> must cover and thus constantly exceed the required capital<sup>845 846</sup>. The latter is composed of the minimum required capital, the capital buffer, the countercyclical buffer, the extended countercyclical buffer, and additional capital.<sup>847</sup> However, required capital does not incorporate risks<sup>848</sup> that need to be backed,<sup>849</sup> for the measurement of which there are different calculation methods.<sup>850</sup>

### (c) Liquidity Requirements

233 After the global financial crisis in 2007 and 2008, the role of liquidity was recognised by the Basel Committee of Banking Supervision in Basel III.<sup>851</sup> In Switzerland, this has been implemented through the Liquidity Ordinance and FINMA-Circular 2015/2 on liquidity risks.<sup>852</sup> The goal of these rules is to maintain an emergency stock of easily realisable assets to cover deposit or contribution withdrawals.<sup>853</sup> This aim gives rise to qualitative<sup>854</sup> and quantitative<sup>855</sup> measures. From a quantitative perspective, the short-term liquidity coverage ratio (LCR), a type of minimum liquidity ratio, is significant. The LCR is intended to ensure that banks hold sufficient high-quality liquid assets (HQLA) to cover all net cash outflows with a time horizon of 30 calendar days.<sup>856</sup> The regulations on liquidity define the amount of equity which must be liquid and therefore constitute indirect regulation of open reserves. The higher the open reserves, the easier it is to achieve the required liquidity.

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<sup>844</sup> Art. 18 et seqq ERV.

<sup>845</sup> Art. 41 et seqq ERV.

<sup>846</sup> ARPAGAU/STADLER/WERLEN, par. 2922; BSK BankG-BINGERT/HEINEMANN, Art. 4, par. 9.

<sup>847</sup> Nonetheless, this buffer is only covered under certain requirements and not always. Art. 41 ERV.

<sup>848</sup> Art. 78 et seq. (non-counterparty risks); Art. 80 (market risks); Art. 89 et seqq (operational risks) ERV.

<sup>849</sup> BSK BankG-BINGERT/HEINEMANN, Art. 4, par. 61 et seqq.

<sup>850</sup> ARPAGAU/STADLER/WERLEN, par. 2848.

<sup>851</sup> *Ibid.* For markets risks, see Art. 82 ERV. For operational risks, See Art. 90 ERV.

<sup>852</sup> NOBEL, Finanzmarktrecht, § 7, par. 606 et seqq.

<sup>853</sup> Cf. NOBEL, Finanzmarktrecht, § 7, par. 615.

<sup>854</sup> As stipulated in FINMA-Circ 15/1 par. 2-103.

<sup>855</sup> As stipulated in FINMA-Circ 15/1 par. 104-363.

<sup>856</sup> Cf. Art. 12 par. 1 Liquidity Ordinance; see FINMA-Circ 15/1 par. 104-363 for details on how this is measured.

## (d) Impact on Reserves

In light of this strict regulation of equity, reserves play a less important role in the protection of equity – especially in Switzerland, where the regulations are even stricter than is required by Basel I-III. However, it is precisely in the banking sector that the option of creating reserves for general banking risks arises. This is an exceptional instrument available to the board of a bank that does not exist in the same form in the non-banking sector. Although banks are required to provide greater equity protection, as reflected in the strict regulations, the question of whether there should also be general risk reserves in the non-banking sector is important. For example, does the greater protection of banks' equity – as required to protect their creditors and to ensure the financial stability of the financial system – justify the additional reserves that banks are allowed to create?<sup>857</sup> Moreover, as has been shown in [Paragraph 159](#), [Paragraph 223](#) and [Paragraph 227](#), the legal basis is not optimal as it involves a transfer of competence from the general assembly to the board of directors. Rather than a framework, the Banking Act should be the legal basis for a transfer of competence. Unfortunately, reserves for general banking risks are only anchored in a FINMA ordinance and a FINMA circular.

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## 3.2.2. Types of Financial Statement

The accounting rules in the Banking Act, the Banking Ordinance, the FINMA Circular on Banking Accounting, and the FINMA Ordinance on Banking Accounting together constitute the financial accounting regulations for banks known as the Swiss Banking GAAP.<sup>858</sup> For banks and financial institutions, the Swiss Banking GAAP is equivalent to the recognised standards.<sup>859</sup>

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<sup>857</sup> Cf. Art. 1 par. 1 ERV.

<sup>858</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 16.

<sup>859</sup> Art. 2 par. 1 VASR.

(1) *Unlisted Non-Banking and Banking Companies*(a) *The Choice between Two Types of Single-Entity Financial Statement*

236 Unlisted companies have a choice between two types of financial statement: a reliable assessment statutory single-entity financial statement or a true and fair view single-entity financial statement.<sup>860</sup> As their names suggest, a statement with a reliable assessment aims to provide third parties with a reliable assessment of a company's financial situation, while a true and fair view statement aims to provide a true and fair picture. Some articles in the CO are not applicable to true and fair view single-entity financial statements.<sup>861</sup> For example, for replacement purposes and to ensure the long-term prosperity of the company, no additional depreciation or valuation adjustments may be made or cancelled (when no longer required).<sup>862</sup> Likewise, no provision may be created for purposes of restructuring<sup>863</sup> or for securing the long-term prosperity of the company.<sup>864</sup> As a result, the inclusion of arbitrary hidden reserves is not permitted in a true and fair view single-entity financial statement,<sup>865</sup> with only involuntary compulsory and discretionary reserves allowed to be included because they are unavoidable.<sup>866</sup> It is problematic that a true and fair view leads to the expectation that the IFRS will be applied; however, in reality, the norms do not apply – even when they are not in contradiction with the IFRS.<sup>867</sup> If the IFRS are partially applied, discrepancies must be recorded in the notes.<sup>868</sup> An annual true and fair view single-entity financial statement also includes a balance sheet, a profit and loss account, and information on equity and cash flow.<sup>869</sup> This information on equity and cash flow, which is only required in a true and fair view statement,<sup>870</sup> constitutes the key difference between both

<sup>860</sup> Art. 25 par. 1 BankV; see also BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 26; GMÜR, *Krisenfeste Schweizer Banken?* p. 154.

<sup>861</sup> Art. 25 par. 2 BankV.

<sup>862</sup> Art. 960a par. 4 CO.

<sup>863</sup> Art. 960e par. 3 no. 2 and 4 CO.

<sup>864</sup> Art. 960e par. 4 CO.

<sup>865</sup> BSK BankG-BERNET/PORTMANN, Art. 6-6a-6b, par. 361 et seq.

<sup>866</sup> BSK BankG-BERNET/PORTMANN, Art. 6-6s-6b, par. 359 et seq.

<sup>867</sup> It would be desirable for at least the norms which do not contradict the CO to be applicable; BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 28.

<sup>868</sup> Cf. Art. 3 par. 2 RelV-FINMA.

<sup>869</sup> Art. 25 par. 3 in fine BankG.

<sup>870</sup> Art. 25 par. 3 in fine BankG.



types of statement: by providing information on every change that has an impact on cash flow and liquidity, this is a much more sensitive instrument.<sup>871</sup> If a simple financial statement is prepared, a true and fair view single-entity financial statement can be added in the notes.<sup>872</sup>

From a legal perspective, reliable assessment statutory single-entity financial statements have a misleading name; a genuinely reliable assessment would not allow for the inclusion of arbitrary hidden reserves, as this type of financial statement does.<sup>873</sup> 237

A more accurate name would be the simpler “statutory single-entity financial statement”.<sup>874</sup> Reliable assessment statutory single-entity financial statements are used for the assessment of profit and as the basis for decisions on the distribution of profit.<sup>875</sup> General banking reserves can be included in both types of financial statement.<sup>876</sup> For this reason in particular, it is preferable to make use of reserves for general banking risks rather than hidden reserves. 238

(b) *Financial Statements in accordance with a Recognised Standard?*

It is possible for qualified minorities<sup>877</sup> to request a financial statement in accordance with the recognised standard, although the company is not required to prepare such a statement.<sup>878</sup> In general, it is mandatory for cooperatives with a minimum of 2,000 members to prepare financial statements in accordance with a recognised financial reporting standard.<sup>879</sup> However, coopera- 239

<sup>871</sup> MEYER, CONRAD pp 25-41.

<sup>872</sup> BSK BankG-BERNET/PORTMANN, Art. 6-6a-6b, par. 52 and 56.

<sup>873</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 27.

<sup>874</sup> BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 27.

<sup>875</sup> BSK BankG-BERNET/PORTMANN, Art. 6-6a-6b, par. 54.

<sup>876</sup> Art. 46 and 59 ReIV-FINMA.

<sup>877</sup> Qualified minorities are: (1) company members who represent at least 20% of the basic capital; (2) 10% of cooperative members or 20% of the members of an association; or (3) any company member or any member subject to personal liability or a duty to pay in additional capital. Art. 962 par. 2 CO.

<sup>878</sup> Art. 25 par. 5 BankV, Art. 962 par. 2 CO; see also BSK OR II-NEUHAUS/KUNZ, Art. 962 par. 4; cf. BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 19.

<sup>879</sup> Art. 962 par. 1 no. 2 CO.

tives are exempted from the banking accounting rules as long as they form part of a centralised organisation that guarantees their obligations<sup>880</sup> and have no equity securities listed on the stock market.<sup>881</sup>

## (2) *Listed Non-Banking and Banking Companies*

240 If a company is listed, it must follow the rules of the applicable stock market: Stock markets can demand a financial statement in accordance with a recognised standard.<sup>882</sup> A Swiss Exchange's Directive on Financial Reporting specifies the accounting standards that are recognised by the Regulatory Board.<sup>883</sup> Issuers of equity must apply an international reporting standard (IFRS or US GAAP) or the main domestic standard (Swiss GAAP FER or, as explained below, the financial reporting standards outlined in the Swiss Banking Act).<sup>884</sup> The applicable standards depend on the respective stock exchange segment. Additionally, the listing rules demand that the issuer must have produced annual financial statements that comply with the applicable financial reporting standard for the three full financial years preceding the listing application.<sup>885</sup> In order for a company to maintain a listing, the listing rules apply some additional conditions: the company's published annual report must comprise an audited annual financial statement that is in accordance with the applicable reporting standards as well as a corresponding audit report.<sup>886</sup> The regulatory board may also require that additional information be included in the annual report, specifically details on the structure and functions of the company's corporate management and governance.<sup>887</sup>

## (3) *Consolidated Financial Statements*

241 Except in the case of unlisted companies, a consolidated financial statement must be prepared in accordance with the requirements of true and fair view single-entity financial statements.<sup>888</sup> Consolidated financial statements in the

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<sup>880</sup> Art. 25 par. 4 lit. a BankV.

<sup>881</sup> Art. 25 par. 4 lit. b and c BankV; see Art. 962 par. 3 CO.

<sup>882</sup> Art. 962 par. 1 no. 1 CO.

<sup>883</sup> Art. 2 Directive Financial Reporting.

<sup>884</sup> Cf. Art. 6 Directive Financial Reporting; cf. BSK BankG-BERNET/PORTMANN, BankG, Art. 6-6a-6b, par. 50; see also BankG Komm-HANDSCHIN, Art. 6-6a-6b, par. 16.

<sup>885</sup> Art. 12 Listing Rules.

<sup>886</sup> Art. 49 par. 1 Listing Rules.

<sup>887</sup> Art. 49 par. 2 Listing Rules.

<sup>888</sup> Art. 33 par. 1 BankV; BSK BankG-BERNET/PORTMANN, Art. 6-6a-6b, par. 59.

regulated banking sector must thus be prepared in accordance with the true and fair view method rather than by following the CO's financial accounting rules.<sup>889</sup> A consolidated financial statement does not serve as the basis for an assessment of the distribution of profit, for which a single-entity financial statement is required.<sup>890</sup> For reserves for general banking risks, the preparation of a consolidated financial statement follows the same rules as for the stricter true and fair statement.<sup>891</sup> For a company limited by shares, a consolidated statement must be approved by the general assembly.<sup>892</sup>

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<sup>889</sup> Art. 963b par. 3 CO.

<sup>890</sup> BSK BankG-BERNET/PORTMANN, Art. 6-6a-6b, par. 62.

<sup>891</sup> Art. 59 in conjunction with 94 RelV-FINMA.

<sup>892</sup> Art. 698 par. 2 no. 3 CO.



## Preliminary Conclusion to Part I

“Reserves” as a term and concept appears in the CO as part of the minimum structure of a balance sheet, as stipulated in Art. 959a CO and Art. 959 par. 7 CO. According to this structure, equity is subdivided into (a) basic, shareholder or foundation capital; (b) legal capital reserves; (c) legal retained earnings (d) voluntary retained earnings or, when negative, accumulated losses; (e) own capital shares, when negative. Reserves are legally defined as equity; as such, the CO assigns shareholders certain rights and a basis of liability. The function of reserves is to fulfil the role of a risk reserve for a company, and thus increase its risk capacity. Reserves protect capital by raising the minimum distribution limit for payouts to shareholders or company members. Historically, the goal of a minimum distribution limit has been to maintain companies’ internal stability, an aim which has been prioritized over the rights of shareholders.

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In a first step, it was important to compare reserves to provisions, as defined in Art. 960e par. 2 CO. Provisions are very similar to reserves, but there are basic differences between the two concepts. In a broad sense, provisions could be considered a type of reserves – namely, a reserve for an uncertain future cash outflow, for which the likelihood of occurrence is more than 50%. Provisions are thus characterized by uncertainty and their temporally limited nature. The latter characteristic is also common to reserves. Reserves and provisions both have the same impact: their creation reduces the value of the dividends that can be distributed by a company. The main difference is that the creation and dissolution of reserves is generally – with the exception of accounting reserves, hidden reserves and reserves for general banking risks – a competence of the general assembly; by contrast, the competence for the creation and dissolution of provisions is in the hands of the board. While the CO permits both mandatory and voluntary creation of both reserves and provisions, another difference is that provisions are defined as debt capital, as per Art. 959a par. 2 no. 2 lit. c CO, while reserves are classified as equity, as per Art. 959a par. 3 no. 3 lit. b-d CO. Another difference is that provisions are defined as debt capital as per Art. 959a par. 2 no. 2 lit. c CO, while reserves are equity as per Art. 959a par. 3 no. 3 lit. b-d CO. As liabilities, provisions are also counted as uncovered claims in case of over-indebtedness, according to Art. 725 par. 2 CO (Art. 725b revCO). Furthermore, provisions always have an impact on the profit and loss account. However, the competence to create reserves falls under the authority of the general assembly, while the board of directors is competent for the creation of provisions.

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- 244 If the requirements in par. 2 have not been fulfilled, a provision may be reported as a hidden reserve in the manner stipulated in par. 3. Hidden reserves may also be created as per par. 2 when a potential cash outflow has not occurred, a provision has not been dissolved, or the value thereof is lower than expected. Furthermore, dissolution of provisions, a process which is clearly defined in taxation law, is mandatory; if dissolution does not occur, provisions are attributed to the taxable profit, a step which is not in compliance with the authoritativeness principle.
- 245 Cookie jar reserves are another concept similar to reserves. They first arose in 1890 in the United States and were later also known as war reserves. Cookie jar reserves need to be clearly distinguished from the open reserves described in this work because they represent a misleading concept for investors. Cookie jar accounting involves either reporting a lower income in an earlier period or debiting a higher-than-necessary amount that gives rise to a lower income in the current period so that management can report a higher income in a later period. As they are not disclosed, cookie jar reserves are not genuine reserves; instead, they simply refer to a secret and prohibited accounting technique.
- 246 Reserves are divided into hidden and open reserves according to whether they are reported on the balance sheet. Open reserves, as the topic of study in this work, must be distinguished very clearly from hidden reserves, whose use should be minimised and *de lege ferenda* abolished if possible. Hidden reserves remain unreported due to their as of yet unrealised nature, which is covered equity. Unlike open reserves, hidden reserves are attributed to a specific asset or liability. As such, hidden reserves represent the unreported values when liabilities are overvalued or when assets are undervalued, as legitimised by the prudence principle. This method of reporting is tolerated more by the Swiss tax authorities than their counterparts in other countries. Consequently, open reserves should be employed as much as possible.
- 247 Historically, the creation of hidden reserves was justified in times of crisis. The board of directors, which is competent for the creation and release of hidden reserves, could thus react immediately and independently of the general assembly, a necessary empowerment in times of crisis that was even stipulated in the old Art. 664 par. CO (until 2012). However, this was later rightly recognised as dangerous due to the opportunity it provided for hiding losses and concealing other information from the general assembly.
- 248 Hidden reserves are divided into forced, arbitrary and discretionary reserves. Forced hidden reserves and discretionary hidden reserves arise from the principle of prudence.

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Forced reserves, which are the difference between the highest legal value and the real value, also arise from the cost-value principle. As forced reserves do not affect the profit and loss account, they do not distort a period's profit. The only codified hidden reserves are forced hidden reserves that can be dissolved in a crisis situation, as per Art. 725c revCO (Art. 670 CO). This option allows for the revaluation of land, buildings or equity attributed to the hidden reserves in combination with the creation of a revaluation reserve, another type of open reserve. 249

Arbitrary reserves represent the difference between the highest legal value and its deliberately underreported carrying value. The formation of arbitrary reserves is thus at the discretion of the board. Replacement reserves or reserves for replacement purposes and reserves that ensure the long-term prosperity of a company, as per Art. 960a par. 4 CO, extended provisions, as per Art. 960e par. 3 no. 4 CO, and provisions that are no longer needed, as per Art. 960e par. 4 and 960a par. 4 cl. 4 CO, are all arbitrary reserves. 250

Discretionary reserves belong to the same type of reserves as arbitrary reserves but, unlike the latter, are justified by the prudence principle. Prohibited hidden reserves are fictitious debts or expenses owed to non-existent foreign suppliers that never rendered a service. 251

Generally, the creation of hidden reserves affects the profit and loss account and thus reduces a company's profit. The norms that allow for the creation of hidden reserves involve a transfer of competences from the general assembly to the executive body. However, although their creation falls under the competences of the board, hidden reserves represent equity. As a result, since all decisions on equity should fall under the competences of the general assembly, the concept of hidden reserves is already problematic. 252

The dissolution of hidden reserves can either be neutral or affect the profit and loss account. Only the latter is significant due to the impact on profit. One solution to the problem of hidden reserves is to disclose them. Although this is not possible for forced or discretionary hidden reserves, strict disclosure should be required for arbitrary reserves *de lege ferenda*, which would mean the dissolution of genuine hidden reserves and their conversion into an open reserve. However, Art. 959c par. 1 no. 3 CO requires only the disclosure of the difference between the dissolved hidden reserves and the newly created hidden reserves, thus allowing for offsetting and a consequent loss of transparency. Nevertheless, a minority of company members or shareholders can compel a company to disclose their hidden reserves based on Art. 962 par. 2 CO. 253

- 254 Generally, open reserves are divided into statutory reserves (Accounting Reserves and Legal Reserves) and reserves that are at the discretion of the general assembly (reserves based on the articles of association and reserves based on a resolution by the general assembly).
- 255 Accounting reserves, as the name indicates, are based on accounting law. The board of directors has the competence to create and dissolve accounting reserves as part of its non-transferable and inalienable competences for the organisation of the accounting, financial control and financial planning systems, as per Art. 716a par. 1 no. 3 CO. However, revaluation reserves and negative reserves are not governed by the general accounting rules but by a section of company limited by shares law. Accounting reserves are usually divided into revaluation reserves, fluctuation reserves and negative reserves (revCO: negative items).
- 256 Revaluation reserves, as per Art. 725c CO (Art. 670 CO), are a modern concept that serves to prevent over-indebtedness due to an excessively low valuation of land, buildings or equity participations when reporting the fair value, as is required by the standards for all assets. As such, changes in valuation may be reflected in the revaluation reserves, as a consequence of which the hidden reserves decrease in value each time a revaluation reserve is created. Although a revaluation reserve may be created in the profit and loss account or listed on the balance sheet, it has no impact on the profit and loss account and is thus protected from distribution. Dissolution may occur through a conversion into share capital, a fresh write-down or the disposal of the revalued assets. Correctly, the HWP as well as the new Art. 725c par. 1 in fine revCO (Art. 670 CO) require a disclosure of revaluation reserves. According to the Standards, a revaluation to fair value requirement in conjunction with a mandatory formation of a corresponding revaluation reserve should be extended to apply to all assets as in International Standards. Furthermore, tax law should be adapted accordingly; in divergence from the authoritative principle, tax law currently does not recognise a revaluation reserve as a business-justified expense, as a result of which the formation of hidden reserves is typically preferred.
- 257 Fluctuation reserves, according to Art. 960b par. 2 CO, are revaluation reserves with an unlimited scope of application for assets with a stock exchange price or another observable market price in an active market. As an instrument, fluctuation reserves help to achieve greater transparency and precision. Their creation is voluntary and allows for a valuation adjustment to be charged to the profit and loss account. According to Art. 960b par. 2, fluctuation reserves must either be disclosed on the balance sheet or in the notes to the accounts.



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Although the formation of fluctuation reserves is at the discretion of the company, this is recommended as it is required by the Standards and rightfully represents the most prudent choice. A valuation adjustment that is not accompanied by the creation of a reserve affects the profit and loss account, but when a reserve is created a valuation adjustment has a compensating effect and ultimately does not impact the profit and loss account.

The third category of accounting reserves are negative reserves, as regulated by Art. 659a par. 2 CO, which states that a company must set aside an amount equivalent to the cost of acquiring its own shares as a separate reserve. The goal of this category of reserve is to prevent a pay-out to the investors that exceeds the limit on the distribution of dividends. Negative reserves are not only applicable to LLCs and cooperatives, but they are also mandatory for companies limited by shares. The previous method of reporting was more compatible with the CO: Negative items come into conflict with the principle of fixed capital.

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The creation of legal reserves also follows a series of mandatory rules. The creation of additional legal reserves is possible, while their dissolution is at the discretion of the company if they reach a certain value. In contrast to accounting reserves, which fall under the competence of the executive body, the general assembly or the members' meeting has the competence to create and dissolve legal reserves. The current general rules, which as per Art. 671 CO require the creation of legal reserves via two allocations, will be replaced by less complex and more specific allocation rules. Currently, the first allocation is limited to no more than 20% of the share capital, while the second allocation has no upper limit. The maximum value of the first allocation is determined by the annual profit and that of the second by the value of the distributed profit shares or dividends. Legal reserves are divided into legal capital reserves and legal retained earnings reserves according to their origin and properties. Furthermore, this division is also important due to the tax-free distribution of capital reserves (in the form of privately held shares), which stands in contrast to the non-tax-free distribution of retained earnings reserves.

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Capital reserves are paid-in capital that has been paid in by the equity providers, shareholders or company members and which exceeds the share capital. Art. 671 par. 1 revCO, which entered into force in January 2020, provides for only a single allocation to the capital reserves.

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- 261 Retained earnings reserves are reserves created by a statutory allocation of a company's profit: for companies limited by shares as per Art. 671 CO, for limited liability companies as per Art. 801 CO, and for cooperatives as per Art. 860 CO.
- 262 For the creation of retained earnings reserves, only one allocation of 5% of the annual profit must be allocated until the threshold of 50% is reached (the current law places this threshold at only 20%). This means that retained earnings reserves effectively have only one source of allocations. Revaluation reserves and negative reserves should be listed as two separate sub-items under the category of retained earnings reserves. However, according to the minimum structure of the balance sheet as per Art. 959a par. 2 no. 3 CO (Art. 959c par. 2 no. 9 revCO), it is only mandatory to list the negative reserves, but a separate disclosure of the revaluation reserves is wrongly not required. The same rules for dissolution and use apply to both categories of legal reserves. Besides the rule that they may not exceed one-half of the value of the share capital, the use of legal reserves is restricted to covering losses or supporting measures designed to sustain the company through difficult times, prevent job losses or mitigate the consequences thereof. This threshold of 50% is also included in the new legislation, although use of legal reserves is no longer restricted to these three conditions but is now rightfully, completely open-ended and thus at the full discretion of the general assembly.
- 263 According to the revised legislation, legal reserves are thus free to be used to repay shareholders or company members, as per Art. 671 par. 2 revCO and Art. 672 par. 3 revCO. In relation to the question of the distribution of *agio*, the Federal Tribunal correctly ruled that *agio* should be treated like reserves and should therefore enjoy no protection. However, the legislation does not include any new references to *agio* but clearly states that both categories of legal reserves follow the same rules for their dissolution and utilisation.
- 264 Finally, the subcategory of voluntary or free retained earnings reserves exists under the category of retained earnings reserves. This term in Art. 673 revCO is new, but it brings with it no material changes. Art. 673 par. 2 revCO restricts the creation of voluntary retained earnings reserves only to situations in which they are in the best interests of the company and protect its long-term prosperity. Voluntary retained earnings reserves are based on the articles of association or on a resolution by the general assembly. As voluntary retained earnings reserves are not statutory reserves, their disclosure is mandatory according to Art. 959a par. 2 no. 3 lit. d CO.

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The creation of reserves based on the articles of association requires no special justification but only sufficient freely available retained earnings or equity and a corresponding amendment of the articles of association by the general assembly. Furthermore, based on Art. 673 par. 1 revCO, ad hoc voluntary retained earnings reserves, otherwise known as so-called extraordinary reserves, may be created through a resolution by the general assembly. In practice, such reserves based on a resolution by the general assembly are used much more frequently than reserves based on the articles of association. As this work promotes a more extensive use of reserves based on the articles of association, the focus of the analysis has been on investigating the potential of this instrument.

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A shift of perspective to the banking sector has outlined a special category of open reserves that is only for unforeseen risks emerging in banks and which is not applicable in the non-banking sector. This reserve for general banking risks is stipulated in FINMA-Circular 2020/1 in par. 18 as well as in Arts. 46 et seq. and 50 et seq. of the Banking Accounting Ordinance (ReIV-FINMA). The board of directors is competent for creating and releasing reserves for general banking risks. Because this type of reserve should fall under the competence of the general assembly, it should thus represent a transgression of the latter's competences. However, although reserves for general banking risks are open and not hidden, this is a concept that is comparable to hidden reserves: like hidden reserves, the formation and dissolution of reserves for general banking risks fall under the competences of the board of directors. Moreover, both categories of reserves have the same impact by reducing the accumulated earnings until they reach the amount at which the requirement for distribution is no longer applicable and the distributable equity is thus blocked. The difference is that reserves for general banking risks are for unexpected risks, while provisions are for expected risks. Furthermore, provisions are potential liabilities, while reserves are equity. Ultimately, the creation of provisions is mandatory according Art. 960e par. 2 CO, while the creation of reserves for general banking risks is voluntary.

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Unlike in the non-banking sector, some categories of open reserves that are stipulated in the CO are not applicable to banks, including fluctuation reserves and revaluation reserves. Hidden reserves are only permitted in reliable assessment statutory single-entity financial statements and not in true and fair view single-entity financial statements. Negative reserves, like all retained earnings reserves, are applicable in the banking sector.

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- 268 Chapter 3 on the regulation of reserves demonstrated how important it is that there are no exceptions to the authoritative principle; reserves become less attractive if they are recognised in the CO but not in taxation law. Furthermore, since the going concern principle and the presumption that a company is “on going” is no longer applicable, hidden reserves must now be made visible. Valuation reserves are an instrument to prevent a premature change of valuation system when a company is at risk of losing its going status. Reserves comply with the periodical principle as they must either adhere to the CO’s clear regulations for their creation and dissolution or follow requirements that have been stipulated in the articles of association.
- 269 In contrast, provisions formed as per Art. 960e par. 2 no. 4 CO are created in a good period with the goal of ensuring the long-term prosperity of the entity. Like hidden reserves, provisions may remain hidden in order to be dissolved in a later “rainy period”. As such, all types of provisions operate like the prohibited cookie jar reserves, since the prudence principle, as outlined in Art. 958c par. 1 no. 5 CO, is fundamental to the legitimisation of reserves. On the other hand, prudence as a valuation rule requires reporting to fair value, as stipulated in the CO, and thus involves a general prohibition on revaluation. However, revaluation reserves as well as fluctuation reserves rightfully constitute an exception to the realisation principle, which is derived from the prudence principle.
- 270 The question also arises as to whether the prudence principle contradicts the requirement in Art. 958 par. 1 CO, according to which the financial reporting should reflect the financial position of the company in such a manner that third parties can make a reliable assessment thereof. However, rather than hindering the reliable assessment of a company’s financial position, prudent valuation should support this aim. Ultimately, reserves are an instrument of prudence whose disclosure allows for a reliable financial report. This means, for example, that the formation of a revaluation reserve is not prudent because it lacks transparency and impedes a reliable financial report. On the other hand, reserves for general banking risks are permitted as they are prudent and do not prevent a reliable financial assessment. Additionally, according to Art. 959 par. 1 CO, a financial report must be transparent, a rule from which the principle of reliability, as per Art. 958c par. 1 no. 3 CO, as well as the principles of clarity and comprehensibility are derived. The CO’s almost unlimited option to form hidden reserves contravenes these principles, especially the reliability principle, since the minimum structure requirements and thus the disclosure of reserves implies a proscription on offsetting. However, newly

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formed and the older not dissolved hidden reserves should be disclosed separately. Furthermore, the offsetting of reserves with the annual losses must follow a strict sequence, as per Art. 674 revCO, and is therefore *not* unregulated.

Ultimately, this work understands reserves as unifying the principle of prudence – in its assumption that the decision to form reserves, when possible, is the most prudent choice – and the principle of transparency with the aim of offering a reliable assessment through the disclosure of reserves. 271

Reserves in the banking sector, including reserves for general banking risks, are subject to the financial sector regulations. The Banking Act is a framework legislation, the purpose of which is to protect creditors as well as the stability of the Swiss financial industry. The Banking Act defines the term “bank” as a company that is mainly active in the financial sector and which advertises for and accepts deposits from the public. The precise legal form of a banking company is not relevant to this definition. The Banking Act is applicable by analogy to securities firms and other financial institutions as well as portfolio managers, trustees, managers of collective assets and fund management companies. However, as such institutions are not banks, they are not subject to general banking risks, although they are subject to the banking accounting rules. 272

The banking accounting rules have four sources: The Banking Act, the Banking Ordinance and the two standards issued by FINMA (a circular and an ordinance). Art. 6 par. 3 Banking Act refers to the principles of the CO, which serve as the basic rules from which deviations are permitted under specific conditions. The Banking Ordinance, which also repeats the principles of the CO, stipulates two types of statement (the reliable assessment statutory single-entity financial statement and the true and fair view single-entity financial statement). 273

Reserves for general banking risks were stipulated in the ordinance but were later moved to the notes as an item to be included in the minimum structure of the balance sheet. However, as such a norm contains the possibility of a delegation to the board of directors of the competence to create and dissolve reserves belonging to the general assembly, it should be anchored in a Federal Act and not only in an ordinance, such as the RelV-FINMA, or a circular. Although the regulation was optimized in the most recent, in which it was defined in more detail, its normative level was lowered gradually from that of a law to the notes of an ordinance before finally being included in a new ordinance and circular. 274

- 275 Currently, the empowerment to create and dissolve reserves is anchored in FINMA's circular FINMA-Circ 2020/01 as well as in its ReIV-FINMA ordinance. The circular regulates the creation and release of reserves for general banking risks and requires the disclosure thereof as part of the following sequence: share capital, retained earnings reserves, reserves for general banking risks, voluntary earnings reserves, accumulated retained earnings or losses, negative reserves for own contributions, and the period's profit. The ordinance differentiates between a reliable assessment statutory single-entity financial statement, in which reserves for general banking risks do not affect the profit and loss account according to Art. 46 ReIV-FINMA, and a true and fair view single-entity financial statement, in which the creation or dissolution of reserves has an impact on the profit and loss account according to Art. 59 ReIV-FINMA. As such, this represents an improvement on the new law. However, in my opinion, there is no reason to differentiate between these two types of statement besides the fact that doing so clearly promotes the utilisation of reserves for general banking risks instead of hidden reserves.
- 276 Ultimately, there are strict equity and liquidity requirements in the banking sector, as reflected in the option to make use of reserves for general banking risks as an additional type of special reserve. However, the different ways in which equity and liquidity are calculated are not correlated to the general banking risks described in the FINMA circular and ordinance.
- 277 In conclusion, companies in the banking sector have an additional instrument available to them due to the general risks inherent to the sector, which have consequently created the need for stricter equity and liquidity regulation. Nonetheless, this still may not justify the empowerment of the board of directors through an ordinance or a FINMA circular. It would be preferable if this delegation power was anchored directly in the Banking Act. I conclude, however, that reserves for general banking risks as such are appropriate and necessary as an additional type of risk reserve in the banking sector. Moreover, they would be equally appropriate and beneficial in the non-banking sector.

## II. The Competence to Form and Release Reserves





## Preliminary Remarks to Part II

As seen in Part I, the board of directors in companies limited by shares has the competence to form accounting reserves, while legal reserves are created by the general assembly. This difference arises from the competence enjoyed by the general assembly in relation to decisions concerning profit and dividend distributions; the board of directors, meanwhile, has the authority for decisions relating to accounting and thus enjoys the competence to create accounting reserves. Hidden reserves are also created by the board, as are reserves for general banking risks, which in this work are preferred over hidden reserves. 278

Part I focused in particular on reserves for general banking risks, a statutory special category of reserves. Reserves for general banking risks involve a transfer of competences from the general assembly to the board. Considering in light of the discussion above, the key question is whether such a transfer of competences is also possible in the non-banking sector as it is in the banking sector? Furthermore, may the board of directors redelegate this competence to a more specialised manager? In order to answer these questions, Part II focuses on the allocation of competences between the general assembly and the board of directors in the following three types of entities: companies limited by shares, limited liability companies and cooperatives. Thereafter, similarities and differences relating to the allocation of competences in these three types of entities will be described. Although their shared characteristics will result in some common descriptions, their respective differences mean that the allocation of competences and the available delegation options will be analysed separately for each type of entity, giving rise to three different sets of answers to the above questions. 279

After considering all the ways in which these three types of entities diverge in the non-banking sector, the types of entities in the banking sector for which reserves for general banking risks are applicable will be described. The reasons and justifications for having an additional statutory type of reserves that is valid only for banks will then be analysed. 280

The fundamental question is whether the current instrument in the CO – namely, reserves based on the articles of association – could fulfil the same function in the non-banking sector as reserves for general banking risks in the banking sector. Does the CO allow for the competence to create and dissolve reserves to be delegated from the general assembly to the board of directors? 281

The consequences of this answer for the distribution of competences between these two bodies will be analysed in relation to the three types of entity. Could this option offer an opportunity for creating a category of open reserves in the non-banking sector that the board of directors would finally have the competence to create and dissolve?

282 Does this achieve the same results as for reserves for general banking risks?

# 1. Non-Banking Sector

Reserves for general banking risks are only permitted in the banking sector. In the non-banking sector, this work favours using risk reserves based on the articles of association, for which a delegation by the general assembly to the board of directors is necessary. 283

## 1.1. Companies Limited by Shares

### 1.1.1. Parity Principle

Before introducing the question of competences, an overview of the distribution of powers in companies limited by shares is first provided with the aim of examining the questions below in detail and in the context of the distribution of powers and related tensions as a whole. 284

#### (1) *Omnipotence Theory or Parity Principle?*

The parity principle aims to ensure a strict separation of powers, with each organ of a company limited by shares having its own non-transferable competences.<sup>893</sup> The inalienable competences of the general assembly and those of the board of directors are listed in the CO.<sup>894</sup> According to the parity principle, these two organs enjoy equal status and are not positioned within a hierarchy in which one is more powerful than the other.<sup>895</sup> In addition to the above-mentioned inalienable competences, the general assembly has further inalienable competences that are stipulated in individual articles, such as the competence to create and release reserves. 285

In contrast, according to the omnipotence theory, one organ enjoys executive supremacy. For example, as per Art. 698 par. 1 CO, the general assembly is considered the governing body of a company limited by shares, although this sta- 286

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<sup>893</sup> DRUEY/GLANZMANN, *Gesellschafts- und Handelsrecht*, § 12 par. 1; Cf. MEIER-HAYOZ/FORSTMOSER/SETHE, *Gesellschaftsrecht*, § 16 par. 468 et seq; BGE 100 II 384 consideration 2a; BGE 78 II 369 consideration 3c; already in *Botschaft* 1983, p. 842 and the current *Botschaft* 2016, p. 455.

<sup>894</sup> Art. 698 par. 2 no. 1-6 CO (Art. 698 par. 2 no. 1-9 revCO) and Art. 716a par. 1 CO (Art. 716a par. 1 revCO).

<sup>895</sup> DRUEY/GLANZMANN, *Gesellschafts- und Handelsrecht*, § 12 par. 1 and 19; BÖCKLI, *Aktienrecht*, § 12 par. 3 and § 13 par. 286.

tus is seen as symbolic and without any material significance.<sup>896</sup> While the general assembly does have the competence to assign itself unallocated competences by means of the articles of association<sup>897</sup> – thus indicating a degree of supremacy on its part – there are few potential competences which it could allocate to itself in this manner.<sup>898</sup>

## (2) *A Slight Relativisation of the Parity Principle*

287 The general assembly of a company limited by shares, which has the competence to appoint the members of the other executive organs, the board of directors and the external auditors, thus enjoys the authority to make personnel decisions.<sup>899</sup> Additionally, the general assembly is entitled to dismiss the members of the board of directors it has appointed.<sup>900</sup> Consequently, the general assembly may indirectly influence the members of the board of directors by threat of dismissal, and thus impact decisions on topics that fall under the inalienable powers of the board.<sup>901</sup> For example, if a business strategy is considered false by the general assembly, it can threaten to sanction the current board by choosing not to reappoint its members.<sup>902</sup>

### 1.1.2. General Assembly

288 Art. 698 CO, which contains the general assembly's inalienable and non-transferable competences, differentiates between the competence to approve a matter and the full competence to pass a resolution.<sup>903</sup> Full competence of decision applies when the general assembly has significant scope of discretion to make material decisions, while competence of approval only allows for the acceptance or rejection of a proposal by the board of directors.<sup>904</sup> The interplay

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<sup>896</sup> Cf. BSK OR II-DUBS/TRUFFER, Art. 698 par. 8; DRUEY/GLANZMANN, § 12 par. 1; VON DER CRONE, § 15 par. 753.

<sup>897</sup> See revCO Art. 698 par. 2 no. 9 (Art. 698 par. 2 no. 6 CO).

<sup>898</sup> DRUEY/GLANZMANN, Gesellschafts- und Handelsrecht, § 12 par. 19 et seq.

<sup>899</sup> Art. 698 par. 2 no. 2 CO; see also Art. 3 par. 1 and Art. 7 par. 1 VegüV; Cf. DRUEY/GLANZMANN, § 12 par. 4 and § 13 par. 49 et seqq.

<sup>900</sup> Art. 705 CO (Art. 705 revCO).

<sup>901</sup> BSK II-WATTER/ROTH PELLANDA, Art. 716a par. 1.

<sup>902</sup> Ibid, Art. 716a par. 4; BSK OR II-DUBS/TRUFFER, Art. 698 par. 8.

<sup>903</sup> See more in DUBS, SZW 2/2008, 161 et seqq.

<sup>904</sup> BSK OR II-DUBS/TRUFFER, Art. 698 par. 8b.

between these two types of competences are relevant for the question of whether the competence to form or release reserves can be transferred, as will be shown below.

## (1) *Competence to Approve*

### (a) *Management Report*

Undertakings that are required by law to undergo an ordinary audit must draw up a management report as per Art. 961 CO. Information on the business performance and financial position of a company<sup>905</sup> in areas not covered by the annual accounts is also prepared by the board of directors and requires the approval of the general assembly.<sup>906</sup> As such, the general assembly cannot make any changes to the management report, such as reporting a higher or lower net profit.<sup>907</sup> An audit report may be requested by an individual shareholder, but this does not require the approval of the general assembly.<sup>908</sup> 289

### (b) *Annual Accounts*

A further approval competence relates to approval of the annual accounts, which are first prepared by the board of directors.<sup>909</sup> Here again, the general assembly cannot issue binding instructions<sup>910</sup> or amend the annual accounts;<sup>911</sup> its only choice is whether to decline or accept the annual accounts including the reserves or not.<sup>912</sup> 290

<sup>905</sup> Or corporate group. Art. 961c par. 1 CO.

<sup>906</sup> Art. 698 par. 2 no. 3 in conjunction with Art. 961c par. 1 CO.

<sup>907</sup> Cf. MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 551.

<sup>908</sup> See Art. 696 (this norm will be deleted in revCO and is in force until 31 December 2022) and Art. 729 par. 1 CO; BSK OR II-DUBS/TRUFFER, Art. 698 par. 17.

<sup>909</sup> See Art. 698 par. 2 no. 4 CO.

<sup>910</sup> Also BÖCKLI, FS Hirsch, pp 193.

<sup>911</sup> MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 551.

<sup>912</sup> Cf. ZK-BÜRGI, Art. 698 par. 52; BÖCKLI, Aktienrecht, § 12 par. 20; BSK OR II-DUBS/TRUFFER, Art. 698 par. 19.

(c) *Profit Distribution*

- 291 According to Art. 660 par. 1 CO, the shareholders are entitled to a pro rata share of the disposable profit, the distribution of which requires the approval of the general assembly.<sup>913</sup> A resolution in favour of the distribution of profit requires that the general assembly first approve the disposable profit in the annual accounts.<sup>914</sup> This resolution, however, must comply with the rules in Art. 671 et seq. CO, according to which the profit must qualify as equity at the disposal of the general assembly.<sup>915</sup>
- 292 The new Art. 674 revCO as well as the actual Art. 674 par. 1 CO (in force until 31 December 2022) clearly prioritise the creation of reserves over the monetary right of shareholders to receive a distribution of profit in the form of a dividend.<sup>916</sup> The following types of reserves can be created: revaluation reserves, negative reserves, or reserves based on a resolution by the general assembly.<sup>917</sup> The first allocation to the reserves, as described in the chapter on reserves below,<sup>918</sup> must be completed before the issue of dividends can be discussed.<sup>919</sup> According to SCHUCANY, however, the articles of association may stipulate a different sequence for reserves based on the articles of association.<sup>920</sup> Indeed, the articles of association very often stipulate that allocations to the reserves may be made only after a minimum dividend has been distributed.<sup>921</sup>
- 293 The rules on profit distribution thus show how the general assembly and the board of directors are both involved in this important decision, the approval of which effectively amounts to the shareholders' only interest.

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<sup>913</sup> See Art. 698 par. 2 no. 4 CO.

<sup>914</sup> DRUEY/GLANZMANN, *Gesellschafts- und Handelsrecht*, § 12 par. 12; DUBS, FS Böckli, pp 460; VON DER CRONE, § 12 par. 12.

<sup>915</sup> BSK OR II-DUBS/TRUFFER, Art. 698, par. 21.

<sup>916</sup> ZK-BÜRGI, Art. 674 par. 3.

<sup>917</sup> BSK OR II-NEUHAUS/BALKANYI, Art. 674 par. 5.

<sup>918</sup> See [Paragraph 115 et seqq.](#)

<sup>919</sup> BSK OR II-NEUHAUS/BALKANYI, Art. 674 par. 5.

<sup>920</sup> SCHUCANY, Art. 674, par. 1.

<sup>921</sup> ZK-BÜRGI, Art. 674, par. 4. See also DRUEY/GLANZMANN, *Gesellschafts- und Handelsrecht*, § 12 par. 8.

## (2) *Competence to Decide*

### (a) *Allocation to the Reserves*

Allocation to the reserves is not listed as a general assembly's non-alienable power.<sup>922</sup> Because matters reserved to the general meeting by law or the articles of association also belong to the non-alienable powers, it is to be questioned if the competence to allocate reserves may be a non-alienable and non-transferable power<sup>923</sup> since Art. 674 par. 2 and 3 CO explicitly mention the general assembly. However, Art. 672 CO and Art. 673 CO do not reference the general assembly. As Art. 674 CO is systematically after these two articles, it cannot be understood in the light of Art. 674 CO. Therefore, allocation to reserves according to Art. 672 CO is a transferable competence. With the actual revised new CO, no change with regard to the competences was intended and only the terminology was adapted, although now the revised Art. 673 revCO (Art. 672 CO) explicitly mentions the general assembly. Additionally, the mechanism of an allocation will remain the following: The distribution of profit is tied to allocation to the reserves, since an allocation to the reserves must first be reported before any distribution of profit can occur. Allocations form part of the balance sheet, which must be prepared by the board of directors and then receive the final approval of the general assembly. This shows how an interplay is necessary. A transfer would anyway require an amendment the articles of association, and therefore require the general assembly's consent.<sup>924</sup>

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### (b) *Articles of Association*

In contrast, the competence to (determine and) amend the articles of association is an inalienable power of the general assembly.<sup>925</sup> It is also a potential legal basis for the supremacy of the general assembly, as outlined above. Art. 672 par. 1 CO (Art. 673 revOR) gives the general assembly the transferable power to create further reserves by means of the articles of association. This includes the authority to delegate this power to another body, namely the board of directors, which may thus decide on whether to create and release reserves itself.

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<sup>922</sup> Art. 673 par. 1 revCO; see Art. 698 par. 2 CO.

<sup>923</sup> See Art. 689 par. 2 no. 9 revOR (Art. 698 par. 2 no. 6).

<sup>924</sup> As also art. 673 par. 1 revCO requires it.

<sup>925</sup> See Art. 698 par. 2 no. 1 CO, DRUEY/GLANZMANN, *Gesellschafts- und Handelsrecht*, § 12 par. 8; VON DER CRONE, § 17 par. 918.

### (3) *Transfer of the Competence to Form and Release Reserves?*

- 296 The competence to create and release reserves is related to the competences enjoyed by the board of directors, but it is a transferable competence that belongs to the general assembly.<sup>926</sup> In case this competence is transferred to the board of directors by means of the articles of association, as per the new Art. 673 par. 1 revCO, the general assembly does not lose its power to decide on the distribution of profit, which is a non-transferable competence. The new wording, which explicitly mentions the general assembly in relation to the creation and dissolution of reserves, should not to be understood as a stipulation of an inalienable competence, since any such reserve would be grounded in the articles of association, as Art. 672 par. 1 CO (Art. 673 par. 1 revCO) requires. Moreover, any decision on a transfer of competences remains at the discretion of the general assembly.
- 297 It should be noted that the articles of association may stipulate – regardless of the allocation rules in the CO – to what extent the board is allowed to create and release reserves or whether it has full discretion to do so. In addition, there is also the option of transferring this competence for a limited period of time or tying it to a specific condition or event.
- 298 Ultimately, the general assembly is also free to influence the decisions of the board of directors by refusing to approve the financial report or by invoking the threat of removal or non-reappointment of the board of directors.

#### 1.1.3. Board of Directors

##### (1) *Remedies*

- 299 Resolutions of the general assembly that violate the law or the articles of association may be challenged by the board of directors.<sup>927</sup> For example, a decision taken by the general assembly in violation of a competence may be challenged.<sup>928</sup> At first glance, the reasons for this right to challenge are based more

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<sup>926</sup> ZK-HANDSCHIN, Art. 672-674 (Art. 673, 674, 675 Abs. 3 revCO), par. 7 et seq.

<sup>927</sup> Art. 706 par. 1 CO.

<sup>928</sup> BSK II-WATTER/ROTH PELLANDA, Art. 716 par. 11.



on the protection of the shareholders, but the board of directors *in corpore* is mentioned at the beginning of the article.<sup>929</sup> The courts appoint a representative for the company when the board of directors is the claimant.<sup>930</sup>

## (2) Competences

### (a) *Subsidiary General Competence*

The board of directors may pass resolutions on all matters not reserved to the general assembly by law or by the articles of association.<sup>931</sup> As such, the board possesses what is termed a subsidiary general competence.<sup>932</sup> Ultimately, this negative presumption of competences shows how important the board of directors is in practice compared to the general assembly, which only passes resolutions once per year depending on the requests and information submitted by the board of directors.<sup>933</sup> In addition, the members of the board of directors have a long-term interest in the success of the company while the shareholders may sell their shares at any time.<sup>934</sup> This last point is relativised, however, because the long-term interests of the board members depend on the length of their period of office as well as their mandate and the existing system of remuneration. The situation is unique for small not listed companies or small family companies where all are involved and all have consequently a long term interest.

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### (b) *Non-Transferable Competences*

Non-transferable competences and duties belonging to the board of directors cannot be transferred upwards to the general assembly or downwards to management by means of the articles of association.<sup>935</sup> This clearly shows that the principle of parity is applicable here and not the omnipotence theory.<sup>936</sup> An

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<sup>929</sup> Cf. DRUEY/GLANZMANN, *Handels- und Gesellschaftsrecht*, § 12, par. 103 et seq.

<sup>930</sup> Art. 706a par. 2 CO.

<sup>931</sup> Art. 716 par. 1 CO.

<sup>932</sup> This is not to be confused with the competence to allocate competences that have not already been allocated by the CO. According to Art. 698 par. 2 no. 6 CO, this “competence-competence” belongs to the general assembly, DRUEY/GLANZMANN, § 12 par. 15-16 and § 13 par. 11.

<sup>933</sup> Cf. MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 573 et seq.

<sup>934</sup> Cf. *Ibid.*, § 16 par. 573 et seq.

<sup>935</sup> Botschaft 1983, p. 921.

<sup>936</sup> *Ibid.*, p. 842; ZK-HOMBURGER, Art. 716a, par. 514.

overview of competences which are closely connected to the formation and dissolution of reserves follows with the aim of comparing the board of director's different competences and finally answering the question of whether the board is the appropriate recipient of the competence to create and dissolve reserves.

(i) *Overall Management*

302 The first non-transferable competence mentioned in the CO is *overall* management, according to which the board of directors may delegate the management of all or parts of the company's business to individual members or third parties.<sup>937</sup> Overall management includes the strategy within the purpose of the company as well as the control of the management.<sup>938</sup> In order to implement the business strategy, the board has the competence to enact regulations and directives, which in practice are typically submitted by management, which is most closely involved in the day-to-day running of the company.<sup>939</sup> Also included under overall management is the implementation of systems for compliance and monitoring as well as risk management.<sup>940</sup> The board does not act alone, but relies on the recommendations and collaboration of management.<sup>941</sup> Most of the other competences listed in Art. 716a par. 1 CO refer to the overall management.<sup>942</sup>

(ii) *Organisation*

303 The board of directors is also responsible for overseeing the main organisational functions and responsibilities, but not for the specifics of their implementation.<sup>943</sup> For example, only the oversight of directly subordinate offices is

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<sup>937</sup> Art. 716b par. 1 CO (Art. 716b par. 1 revCO); cf. MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 595.

<sup>938</sup> BSK II-WATTER/ROTH PELLANDA, Art. 716a, par. 4; for more details, see ROTH PELLANDA, par. 463 et seqq.

<sup>939</sup> Botschaft 1983, pp 921 et seq; cf. BÖCKLI, Aktienrecht, § 13 par. 303 et seqq; ERNY, pp 124 et seqq.

<sup>940</sup> MÜLLER/LIPP/PLÜSS, Der Verwaltungsrat, pp 427 et seqq, CHK-IMARK/LIPP, Art. 663b par. 17, PEYER, pp 71 et seqq and 87 et seqq; for another opinion, see: BAUEN/BERNET, par. 707, Footnote 36.

<sup>941</sup> Cf. MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 598.

<sup>942</sup> Botschaft 1983, p. 921.

<sup>943</sup> Cf. MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 600.

a non-transferable competence of the board of directors.<sup>944</sup> The internal organisation of the company is thus in the hands of the board of directors,<sup>945</sup> which may delegate management and monitoring competences. When the board of directors delegates management competences, organisational rules that provide a clear demarcation of competences are required.<sup>946</sup> The board of directors may reserve its right to approve key decisions taken by management.<sup>947</sup>

### (iii) *Accounting*

The board is responsible for overseeing the accounting as well as financial control<sup>948</sup> and planning.<sup>949</sup> Financial accounting is an information-gathering process that aids the decision-making of management.<sup>950</sup> Financial planning involves more than budgeting, and includes ensuring that a company has sufficient liquidity<sup>951</sup> and the correct proportion of equity to debt capital.<sup>952</sup> 304

### (iv) *Appointment and Dismissal of Persons Entrusted with Management Duties*

The board of directors is responsible for key decisions relating to internal personnel, such as the appointment and dismissal of persons entrusted with management duties.<sup>953</sup> While the competence to appoint and dismiss directly subordinate managers cannot be transferred, the competence to do so for indirectly subordinate positions may be transferred to management.<sup>954</sup> 305

<sup>944</sup> Cf. Botschaft 1983, p. 922; KUNZ, p. 111.

<sup>945</sup> BÖCKLI, Schweizer Aktienrecht, p. 1660.

<sup>946</sup> With the revised CO (Art. 716b par. 1 revCO) an empowerment based on the articles of association laid out in Art. 716b CO will no longer be required.

<sup>947</sup> No. 11 of the SCBP.

<sup>948</sup> This is a core responsibility, BÖCKLI, Schweizer Aktienrecht, p. 1685.

<sup>949</sup> See Art. 716a par. 1 no. 3 CO.

<sup>950</sup> BSK II-WATTER/ROTH PELLANDA, Art. 716a par. 16, in reference to Art. 958 par. 1 CO.

<sup>951</sup> Botschaft 1983, p. 922.

<sup>952</sup> BSK II-WATTER/ROTH PELLANDA, Art. 716a par. 18.

<sup>953</sup> MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 609.

<sup>954</sup> Cf. BGE 128 III 129 consideration 1b.

(v) *Overall Supervision of Persons Entrusted with Management Duties*

306 Where management competences have been delegated by the board of directors to individual directors or third parties, the board is still responsible for overall supervision in the sense of *cura in custodiendo*.<sup>955</sup> Although this is not a genuinely inalienable power, it is listed in the legislation among the inalienable competences. As such, *de facto* supervision as well as the supervision of personnel must remain the responsibility of the board of directors, a role<sup>956</sup> which is clearly related to the duties of overall management.

(vi) *Compilation of the Annual Report*

307 As part of its preparation for the general assembly, the board must prepare – or, more specifically, ensure the preparation of – the annual report.<sup>957</sup> According to Art. 958 par. 2 CO, the annual report contains the annual accounts,<sup>958</sup> comprising the balance sheet, the profit and loss account, and the notes to the accounts. As described below, the board is also responsible for the financial planning and generally also for the accounting. These competences as well as that of the compilation of the annual report also cover the creation and release of hidden reserves by the board of directors. However, it is not the board of directors itself that compiles the annual accounts. Instead, these are submitted to the responsible management body or persons for approval.<sup>959</sup> Thereafter, they must be signed by the chairperson of the supreme management or administrative body<sup>960</sup> as well as the person responsible for financial reporting within the company.<sup>961</sup>

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<sup>955</sup> BSK II-WATTER/ROTH PELLANDA, Art. 716a par. 23.

<sup>956</sup> ROTH PELLANDA, par. 475; *Ibid*, Art. 716a par. 25.

<sup>957</sup> *Ibid*, Art. 716a par. 29.

<sup>958</sup> The financial statements of the entity.

<sup>959</sup> Art. 958 par. 2 sentence 1 CO.

<sup>960</sup> Of the board of directors.

<sup>961</sup> Art. 958 par. 2 sentence 2 CO.

### (3) Delegation

#### (a) Notion

The board of directors manages the business of a company, unless this management responsibility has been delegated.<sup>962</sup> The wording of Art. 716 par. 2 CO shows that, as a general rule, the board of directors is responsible for business management.<sup>963</sup> As such, this results in a functional union<sup>964</sup> between the board of directors, as the supervisory body, and the managing body; this means that the board of directors effectively supervises itself.<sup>965</sup> Management of the company's business is thus the responsibility of all the members of the board of directors.<sup>966</sup> Nevertheless, a business management delegation is possible – and, especially in bigger companies, often necessary.<sup>967</sup> Provision is made for this option in Art. 716b CO (Art. 716b revCO).

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#### (b) Requirements

A delegation required, according to the previous law, the board of directors to be empowered in the articles of association based on which the board prepares its organisational regulations<sup>968,969</sup> – with the revised law an empowerment in the articles of association is no longer necessary, however, the articles of association may still exclude a delegation.<sup>970</sup> However, if the board does not opt for a delegation, business management cannot be delegated and re-

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<sup>962</sup> Art. 716 par. 2 CO.

<sup>963</sup> Cf. DRUEY/GLANZMANN, *Gesellschafts- und Handelsrecht*, § 13 par. 1 et seqq; FORSTMOSER, *Unternehmensverfassung*, pp 688 et seqq.

<sup>964</sup> According to the monist system, BSK II-WATTER/ROTH PELLANDA, Art. 716b par. 1. For more details, see ISELI, § 2 par. 231 et seqq.

<sup>965</sup> Botschaft 1983, p. 747.

<sup>966</sup> Art. 716b par. 3 CO (Art. 716b par. 3 revCO).

<sup>967</sup> This resembles a dualist system, but a pure dualist system is not permitted. BSK II-WATTER/ROTH PELLANDA, Art. 716b par. 1; Botschaft 1983, p. 747. For the differences in the banking sector, see [Paragraph 368](#).

<sup>968</sup> For the content and requirements of the regulation: BGer 4A\_248/2009 of 27/10/2009, consideration 5, 6.1. It requires a resolution according to Art. 713 CO, VON MOOS-BUSCH, p. 61; BAUEN/VENTURI, par. 357.

<sup>969</sup> Art. 716b par. 1 CO (Art. 716b par. 1 revCO); cf. MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 623 et seqq; cf. DRUEY/GLANZMANN, *Gesellschaft- und Handelsrecht*, § 13 par. 13 et seq.

<sup>970</sup> See Art. 716b revOR.

mains the responsibility of the board of directors.<sup>971</sup> In addition to this formal requirement, the material requirements stipulate that only transferable competences can be delegated.<sup>972</sup> The organisational regulations stipulate the bodies which can carry this out and defines their duties.<sup>973</sup> In particular, a company must ensure that any delegations comply with the principle of *cura in custodiendo*, which regulates the supervisory process and the written reporting.<sup>974</sup>

(c) *Delegation to the Managing Directors or the CEO*

310 The board of directors may delegate the management of all or part of a company's business to individual members or to third parties.<sup>975</sup> As such, there are two types of managers: on the one hand, delegates or committees that are members of the board; on the other hand, managing directors or a chief executive officer who are non-members of the board.<sup>976</sup> Recently, delegation to a member of the board has become increasingly common, since it has become more common to argue that the current checks and balances serve to restrict the power of individual managers.<sup>977</sup>

311 This trend towards board members serving as managers means that the checks and balances – and thus the restrictions on power – provided by having separate leaders serving on the board and in management have been weakened. As such, subdelegation is becoming more frequently used and the advantages thereof increasingly recognised.

(d) *Subdelegation*

312 There is nothing – no contradicting other regulations – to disallow a delegation of an already delegated competence in the company limited by shares. Indeed, on the contrary, the parity principle means that the allocation of com-

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<sup>971</sup> BUSCH, FS Forstmoser, p. 73.

<sup>972</sup> DRUEY/GLANZMANN, *Gesellschafts- und Handelsrecht*, § 13 par. 17 et seqq.

<sup>973</sup> Art. 716b par. 2 CO; BSK II-WATTER/ROTH PELLANDA, Art. 716b par. 4 and 6 et seq.; DRUEY/GLANZMANN, *Gesellschafts- und Handelsrecht*, § 13 par. 17 et seqq.

<sup>974</sup> Art. 716b par. 2 CO; ZK-HOMBURGER, Art. 716b par. 742; UMBACH, p. 40; VON DER CRONE, § 18 par. 1460.

<sup>975</sup> Art. 716b par. 1 CO.

<sup>976</sup> STUDER, HB *Schweizer Aktienrecht*, § 49, par. 49.1; cf. BSK II-WATTER/ROTH PELLANDA, Art. 716b par. 9; DRUEY/GLANZMANN, *Gesellschafts- und Handelsrecht*, § 13 par. 12.

<sup>977</sup> WATTER/ROTH PELLANDA, p. 71 et seqq; no. 19 SCBP.

petences is not overly strict and allows for many checks and balances. The competence to create and dissolve reserves is very closely related to the competence to approve the financial accounting, which could indicate that the former competence is inalienable and that, based on Art. 716a par. 2 CO, only the delegation of the responsibility for preparing and implementing its resolutions or monitoring transactions to committees or individual members would be possible. However, this rule is only valid for genuine competences and not for already delegated competences. Furthermore, decisions on the distribution of profit are based on the reports compiled by the board, although the latter can delegate this responsibility to a specialist. Ultimately, in any case, the final approval of the general assembly is required, which consequently does not suffer a loss of its authority. As a delegation is based on the articles of association, already during the amending stage can a delegation be authorised, rejected or restricted to a delegation to the board that explicitly prohibits a further delegation (subdelegation).

#### (4) *Admissibility of a Delegation?*

The competence to form and release reserves which is at the discretion of the general assembly – not sole discretion – according to the wording of Art. 672 par. 1 CO (Art. 673 par. 1 revCO),<sup>978</sup> may be delegated to the board of directors, since this competence was not intended to be inalienable.<sup>979</sup> From a practical perspective, a delegation is favourable due to the distribution of competences: decisions on the distribution of profit and the creation and dissolution of reserves are interconnected and involve an interplay between the board of directors, which prepares the financial reports, and the general assembly, which must ultimately approve any such decisions. 313

Furthermore, a second delegation to a specialist manager seems admissible as the competence to create and dissolve reserves is not a genuine competence of the board of directors. Moreover, it is even more optimal due to the fact that a specialist manager is more closely connected to the day-to-day business of his or her company. Finally, the board enjoys an overall management competence that allows it to maintain supervision over its managers. The organisa- 314

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<sup>978</sup> The revised law will explicitly mention the general assembly's competence to form and release reserves, which until now has only been implicit in light of the general assembly's inalienable authority over the articles of association, as per Art. 698 par. 2 no. 1 CO. The revised law is thus clearer and more reader-friendly, but it does not constitute a substantive change to this area of competences.

<sup>979</sup> See [Paragraph 292](#).

tion of the accounting, financial control and financial planning as non-transferable duties stay in the board of directors' competence according to Art. 716 par. 1 no. 3 CO (see also no. 6).

- 315 As such, the general assembly may delegate its competence to create and release reserves to the board, as per Art. 672 CO (Art. 673 revCO), while the board may in turn redelegate this competence to a manager. In practice, this is very similar to the board of directors' competence to form reserves for general banking risks in the banking sector, while accounting reserves and hidden reserves are also formed by the board of directors. As reserves for general banking risks have a weak legal basis for a delegation<sup>980</sup> and hidden reserves are frowned upon – both formed by the board of directors –, a delegation based on the articles of association is favoured in this work in order to achieve the same result and thus maximum flexibility.

## 1.2. Limited Liability Companies

- 316 Generally, for the question of transfer of the competence to create and dissolve reserves the reasoning above for the company limited by shares is applicable *mutatis mutandis*. Nevertheless, a detailed analysis is preferred by the author.

### 1.2.1. Nature of Internal Relationships

- 317 For reserves, limited liability law refers very generally to the legislation for companies limited by shares.<sup>981</sup> As such, the regulations for legal reserves, reserves for own shares, and reserves pursuant to the articles of association in Art. 671 CO (Art. 671 revCO) et seq. are applicable to the formation, utilisation and release of these categories of reserves.<sup>982</sup> Nonetheless, the structure and organisation of limited liability companies (hereafter LLCs) differs from that of companies limited by shares due to the nature of the relationship between management and the members' meeting. Therefore, this chapter analyses the regulations for creating reserves pursuant to the articles of association and examines how far such competences can be delegated to management.

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<sup>980</sup> See [Paragraph 157 et seqq.](#)

<sup>981</sup> Art. 801 CO.

<sup>982</sup> BSK II-NEUHAUS/BALKANYI, Art. 801 par. 3 et seq.



The main difference between LLCs and companies limited by shares is that LLCs have elements that are person-based: LLCs were intended as an intermediate form between general partnerships,<sup>983</sup> which are person-based, and companies limited by shares,<sup>984</sup> which are purely capital-based.<sup>985</sup> An LLC is defined as an incorporated company with a separate legal personality in which one or more persons or commercial enterprises participate;<sup>986</sup> an LLC is thus legally independent, but not financially independent given that obligations to make additional financial and material contributions can be included in the articles of association.<sup>987</sup> Other differences relate to the existing relationship among the company members in the LLC; although in both there is a relationship between a company limited by shares and its company members,<sup>988</sup> the nature of the latter internal relationship may be contractual.<sup>989</sup> Furthermore, this relationship generates a duty or a responsibility for management and its representatives.<sup>990</sup> The CO grants all members of an LLC a full authority position with basically all competences as they are all managing-members.<sup>991</sup> An LLC can only change from being a self-integrated company to one with third-party management through an amendment to the articles of association.<sup>992</sup> The division of members into managing and non-managing members is therefore optional, with all members of an LLC having the authority to act as managing directors.<sup>993</sup> Given this wide scope of discretion, LLCs occupy a broad space between the range of corporations and partnerships.<sup>994</sup>

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<sup>983</sup> Art. 552 et seq. CO.

<sup>984</sup> Art. 620 et seq. CO.

<sup>985</sup> Botschaft 1928, p. 272.

<sup>986</sup> Art. 772 par. 1 CO.

<sup>987</sup> Art. 772 par. 2 sentence 2 CO; see also BSK II-BAUDENBACHER/GÖBEL/SPEITLER, Art. 722, par. 7 and 34.

<sup>988</sup> HANDSCHIN/TRUNIGER, § 8, par. 2; HANDSCHIN, Swiss Company Law, p. 148.

<sup>989</sup> HANDSCHIN/TRUNIGER, § 8, par. 3 et seqq.

<sup>990</sup> Art. 809 par. 1 sentence 1 CO.

<sup>991</sup> Cf. BSK II-TRUFFER/DUBS, Art. 804, par. 4.

<sup>992</sup> Art. 809, par. 1 sentence 2 CO; MEIER-HAYOZ/FORSTMOSER/SETHE, § 18 par. 117; ZK-VON STEIGER, vor Art. 808-819, par. 3.

<sup>993</sup> Art. 809 CO; HANDSCHIN, Swiss Company Law, pp 148.

<sup>994</sup> Cf. HANDSCHIN, Swiss Company Law, pp 148.

## 1.2.2. Collective Management Responsibility

### (1) Duties

319 The CO assumes that all members of an LLC are authorised and thus obligated to exercise joint management over the company, an assumption based on the principles of a self-integrated company.<sup>995</sup> Although the revision in 2002 made the role of the executive organ similar to that of a company limited by shares, this principle is based on the original idea that LLCs, unlike companies limited by shares, are adapted to the demands facing small companies.<sup>996</sup> In contrast, the owners of a company limited by shares manage their company and constitute its *ipso jure* executive organ<sup>997</sup> without the need for a vote or a declaration of acceptance.<sup>998</sup> Inevitably, by granting all company members management responsibility, the legislation risks conflating the roles and functions of the members' meeting with those of management.<sup>999</sup>

### (2) Voting Weight

320 Despite the shared functions and authority enjoyed by the members' general meeting and management, decisions are voted on by the assembly, with the votes being counted in proportion to capital contributions or, in the case of management, per person.<sup>1000</sup> The articles of association may adopt stricter provisions, such as a requirement for a quorum.<sup>1001</sup> This would allow decisions to only be permitted when at least one assembly member, respectively one board member is present.<sup>1002</sup>

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<sup>995</sup> NUSSBAUM/SANWALD/SCHIEDEGGER, par. 2 et seqq; BSK II-WATTER/ROTH PELLANDA, Art. 809 par. 2 et seqq.

<sup>996</sup> Botschaft 2002, p. 3211.

<sup>997</sup> FORSTMOSER/PEYER/SCHOTT, par. 46; GWELESSIANI/PELIZZONI, REPRAX 3/2014, p. 2.

<sup>998</sup> NATER, p. 24; HANDSCHIN/TRUNIGER, § 8, par. 21.

<sup>999</sup> ZK-VON STEIGER, Art. 809, par. 3. This risk may lead to corporate governance deficits.

<sup>1000</sup> Art. 808 CO; according to Art. 806, voting weight in the members' meeting is based on the nominal value of each member's shares; HANDSCHIN/TRUNIGER, § 10, par. 22 and 79; WATTER/ROTH/PELLANDA, BSK OR II, Art. 809 par. 4 and 18.

<sup>1001</sup> Cf. Art. 809 par. 4; BSK II-WATTER/ROTH PELLANDA, Art. 809 par. 18.

<sup>1002</sup> Art. 808 (in relation to the general assembly) and Art. 809 par. 4; BSK II-WATTER/ROTH PELLANDA, Art. 809 par. 18.

### (3) Chairperson

When a company has two or more managing directors, a chairperson must be designated.<sup>1003</sup> 321

In the case of a deadlocked vote, the chairperson casts the deciding ballot.<sup>1004</sup> 322  
As such, the chairperson's vote has more weight than those of the other members of a self-integrated company. Rightfully the admissibility of the position of co-chairperson is disputed.<sup>1005</sup>

#### 1.2.3. The Relativised Parity Principle

We have seen that an LLC is organised in the form of a self-integrated company when its articles of association contain no special rules; however, the articles of association may override the regulations on self-integrated companies and divide the members into non-managing and managing members.<sup>1006</sup> 323  
In this form of LLC, the question of the allocation and delegation of competences becomes relevant.

### (1) Members' Meeting

The members' meeting is the supreme governing body of an LLC, a status which may lead to the conclusion that the members' meeting has the authority to acquire all competences by virtue of the omnipotence theory.<sup>1007</sup> 324  
However, the omnipotence theory does not designate a hierarchy; instead, it simply denotes that there are allocated duties, – and therefore specific functions – that are inalienable to the members' meeting.<sup>1008</sup> Nevertheless, the members' meeting may *allocate itself* competences<sup>1009</sup> by amending the articles of association.<sup>1010</sup>

<sup>1003</sup> Art. 809 par. 3 CO; Botschaft 2002, p. 3212.

<sup>1004</sup> Art. 809 par. 4 sentence 2 CO; BSK II-WATTER/ROTH PELLANDA, Art. 809 par. 19.

<sup>1005</sup> See BERTHEL, 109, par. 688. For another opinion see: BSK II-WATTER/ROTH PELLANDA, Art. 809 par. 17.

<sup>1006</sup> Cf. Art. 809 par. 1 CO; HANDSCHIN/TRUNIGER, § 10, par. 3.

<sup>1007</sup> HANDSCHIN/TRUNIGER, § 10, par. 4.

<sup>1008</sup> Botschaft 2002, p. 3204.

<sup>1009</sup> MEIER-SCHATZ, FS Bär, p. 265.

<sup>1010</sup> NATER, p. 145.

(a) *Transferable Competences*

325 The CO distinguishes between competences based on the CO and those based on the articles of association; it also differentiates between transferable and non-transferable competences.<sup>1011</sup> As non-transferable competences cannot be delegated to other organs or to a third party, any such decisions would be void; in contrast, where the articles of association provide for transferability, the delegation of competence is only contestable.<sup>1012</sup> Compared to companies limited by shares, the list of non-transferable competences for LLCs is much longer.<sup>1013</sup> For example, the authority to create and release open reserves usually falls under the competence of the member's meeting. In the case of reserves based on the articles of association this is the case. As this competence is not mentioned under the inalienable competences of the members' general meeting in Art. 804 par. 2 CO (Art. 804 par. 2 revCO), it is a contrario transferable.<sup>1014</sup> The new Art. 804 par. 2 no. 5<sup>bis</sup> revCO, however, states that the decision about repaying retained capital reserves is a non-transferable competence. Thus, the voluntary retained earnings reserves analysed here clearly do not fall under this rule, and are therefore transferable. For LLCs, however, the authority to decide on the allocation of (balance sheet) profit – including the setting of dividends and, primarily, the approval of the annual accounts – is non-transferable.<sup>1015</sup> As such, the members' meeting has the ultimate authority to decide how profits are to be used and whether a dividend is to be distributed or not. This includes decisions on the creation or release of open reserves.<sup>1016</sup> Despite the members' meeting's competence to decide on how profits are to be used, any such decision must comply with the regulations in Art. 798 et seq CO as well as the rules in the articles of association on the use and distribution of reserves.<sup>1017</sup> The competence to decide on the allocation of profits thus does not cover the creation of reserves, the competence for which is not grounded in the decision-making authority pertaining to the use of profits, as per Art. 804 par. 2 no. 5 CO, but rather on the regulations governing reserves in company law, which explicitly give the power of decision to the

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<sup>1011</sup> BSK II-TRUFFER/DUBS, Art. 804, par. 11 et seq; ZK-VON STEIGER, Art. 810 par. 2 et seq.

<sup>1012</sup> Ibid.

<sup>1013</sup> FORSTMOSER/PEYER/SCHOTT, *Das neue Recht der GmbH*, p. 96.

<sup>1014</sup> See Art. 673 par. 3 revCO (Art. 672 CO) for the regulations on voluntary reserves based on the articles of association.

<sup>1015</sup> Cf. Art. 804 par. 2 CO (Art. 804 par. 2 revCO).

<sup>1016</sup> ZK-VON STEIGER, 804, par. 2; BSK II-TRUFFER/DUBS, Art. 804 par. 24; see also BSK II-TRUFFER/DUBS, Art. 698, par. 21.

<sup>1017</sup> BSK II-TRUFFER/DUBS, Art. 804, par. 24.

members' assembly. In the case of a loss, the members' meeting also has the authority to choose between the following options:<sup>1018</sup> a transfer to the next account as a loss carried forward, an eradication of the loss through the offsetting of profit carried forward or reserves, or a reduction in the nominal capital<sup>1019 1020</sup>.

### (b) Approvals

Alongside the competences enjoyed by the members' meeting, management also possesses its own competences.<sup>1021</sup> These, however, are restricted in Art. 810 CO in favour of those of the members' meeting.<sup>1022</sup> The articles of association may contain rules stipulating that certain decisions as well as individual matters may be submitted to the members' general meeting for approval.<sup>1023</sup> Consequently, it is possible that even management's inalienable and irrevocable duties may be subject to the approval of the members' meeting, thereby making the distribution of authority much more flexible in an LLC than in a company limited by shares.<sup>1024</sup> As such, the parity principle only applies in a relativised form for LLCs.<sup>1025</sup> The aim of the legislation is to allow LLCs the flexibility to adopt elements from person-based structures like partnerships while being unrestricted by the rigid version of the parity principle that applies to companies limited by shares.<sup>1026</sup> Through the introduction of a division of competences between managing members and non-managing members, the revision also amended this approval article.<sup>1027</sup> This power of approval effectively functions as a right to object to management's resolutions,<sup>1028</sup> which thus depend on no objection being made by the members'

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<sup>1018</sup> Ibid, Art. 804, par. 25.

<sup>1019</sup> Art. 782 CO.

<sup>1020</sup> ZK-VON STEIGER, Art. 810, par. 12.

<sup>1021</sup> Art. 810 CO. These will be described below in [Paragraph 330 et seqq.](#)

<sup>1022</sup> HANDSCHIN/TRUNIGER, § 9, par. 5.

<sup>1023</sup> Art. 811 par. 1 CO. This only affects internal resolutions; Botschaft 2002, p. 3204. Finally, it does not restrict the liability of the managing directors according to Art. 811 par. 2 CO. Cf. Art. 758 CO for board of directors in a company limited by shares.

<sup>1024</sup> HANDSCHIN, GesKR 83, p. 317; FORSTMOSER/PEYER, p. 401; NATER, pp 173 et seq.

<sup>1025</sup> HANDSCHIN/TRUNIGER, § 9, par. 5; HANDSCHIN, Gesellschaftsanteile, p. 93; FORSTMOSER/PEYER/SCHOTT, par. 66.

<sup>1026</sup> Botschaft 2002, p. 3212; FORSTMOSER/PEYER, SJZ, 2007, p. 398 and p. 403.

<sup>1027</sup> Botschaft 2008, p. 1727 et seq; FORSTMOSER/PEYER/SCHOTT, par. 146. Historically, only the form of self-integrated company was possible. See Botschaft 2002, p. 3211.

<sup>1028</sup> Cf. BÖCKLI, GmbH-Recht, 32; MEIER, FS Forstmoser, p. 313.

meeting<sup>1029</sup>.<sup>1030</sup> The CO distinguishes between a mandatory requirement for the members' meeting to approve resolutions<sup>1031</sup> and the optional approval of individual resolutions<sup>1032</sup>.<sup>1033</sup>

(i) *Resolutions by the Management*

327 The articles of association can mandate that certain decisions taken by the managing directors must be submitted to the members' general meeting for approval.<sup>1034</sup> As such, through this mandatory approval requirement, the members' meeting can acquire further competences for itself.<sup>1035</sup> From the moment when it is required by the articles of association, approval becomes the inalienable power of the members' meeting.<sup>1036</sup> Consequently, the balance between this approval requirement and the article stipulating the inalienable powers of the managing members is delicate and subject to dispute.<sup>1037</sup> Besides the mutually exclusive competences,<sup>1038</sup> the CO explicitly states that the managing directors have an inalienable and irrevocable duty subject to any possible objections by the members' meeting, thus illustrating the incoherence of the approval requirement in a system of inalienable and irrevocable compe-

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<sup>1029</sup> NATER, S. 168.

<sup>1030</sup> BSK II-WATTER/ROTH PELLANDA, Art. 811, par. 2. FORSTMOSER/PEYER, SJZ, 2007, p. 398 called it an upwards delegation of competences but ultimately it is not a real move of competences because the resolutions are still decided by the management.

<sup>1031</sup> Art. 811 par. 1 no. 1 CO.

<sup>1032</sup> Art. 811 par. 1 no. 2 CO.

<sup>1033</sup> BSK II-WATTER/ROTH PELLANDA Art. 811, par. 5 and 12; BSK II-WATTER/ROTH PELLANDA Art. 811, p. 399; See also Botschaft 2002, p. 3213.

<sup>1034</sup> SIFFERT ET AL., par. 2; NATER, p. 167.

<sup>1035</sup> BSK II-WATTER/ROTH PELLANDA, Art. 811, par. 6.

<sup>1036</sup> Cf. HANDSCHIN/TRUNIGER, § 13 par. 52.

<sup>1037</sup> Botschaft 2002, p. 3212; HANDSCHIN, Entwicklungen 2008, p. 10; MEIER, FS Forstmoser, p. 298.

<sup>1038</sup> BÖCKLI/FORSTMOSER/RAPP, Expertenbericht zum VE, p. 102. Part of the doctrine argues that the managing directors' inalienable and irrevocable competences cannot be obstructed. BÖCKLI, GmbH-Recht, p. 31. If the members' meeting does not approve a resolution by management, the latter has the right to challenge this decision, HANDSCHIN/TRUNIGER, § 14 par. 9.

tences.<sup>1039</sup> Aggravating this situation, there are no material restrictions on the approval requirement besides the rule in the CO that not all decisions are subject to an approval.<sup>1040</sup>

### (ii) *Individual Questions*

The managing directors may submit matters individually to the members' meeting.<sup>1041</sup> When this occurs, the members' meeting can decide whether or not it wants to make use of the approval.<sup>1042</sup> The discretion of the members' meeting in this regard ends when full authority is transferred to it,<sup>1043</sup> which is not the aim of this regulation on the optional approval of specific questions. In contrast to the mandatory approval requirement explained above, which must be clearly defined in advance, the managing directors can decide on which matters they would like to send to the members' meeting for approval if the articles of association are sufficiently open-ended in this regard.<sup>1044</sup> However, this does not seem compatible with the clear wording of individual and thus specific questions.

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### (c) *The Right of Veto*

The power of veto undercuts the equal distribution of competences within the members' meeting by granting greater weight to the votes of certain members. The articles of association may grant company members the right to veto certain resolutions passed by the members' general meeting.<sup>1045</sup> This veto right, which applies to members as individuals and not to their capital contributions,<sup>1046</sup> is thus a person-based regulation.<sup>1047</sup> The power of veto may be enjoyed by all or only some members.<sup>1048</sup> When all members have a veto right, each decision made by the members' general meeting must be made unani-

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<sup>1039</sup> BERTHEL, par. 692; FORSTMOSER/PEYER, SJZ, 2007, pp 399 et seqq; NATER, p. 173; SIFFERT ET AL., par. 3; WOHLMANN, p. 132.

<sup>1040</sup> Cf. BSK II-WATTER/ROTH PELLANDA, Art. 811, par. 7.

<sup>1041</sup> Art. 811 par. 1 no. 2 CO.

<sup>1042</sup> BSK II-WATTER/ROTH PELLANDA, Art. 811, par. 12.

<sup>1043</sup> SIFFERT ET AL., par. 6.

<sup>1044</sup> NUSSBAUM/SANWALD/SCHIEDEGGER, par. 6; NATER, p. 171.

<sup>1045</sup> Art. 807 par. 1 CO. See Art. 776a par. 1 no. 6 CO for the regulations on companies limited by shares, which will be deleted in the revCO.

<sup>1046</sup> Art. 807 par. 3 CO; Botschaft 2002, p. 3209.

<sup>1047</sup> OLIVAR PASCUAL/ROTH, ST 6-7/2007, p. 470 et seqq; HANDSCHIN/TRUNIGER, § 11 par. 25.

<sup>1048</sup> HANDSCHIN/TRUNIGER, § 13 par. 79; SIFFERT ET AL., par. 6 et seqq.

mously.<sup>1049</sup> A member can receive a temporary or permanent veto<sup>1050</sup> or form part of a collective veto.<sup>1051</sup> It is not possible, however, for a member to enjoy a general veto right over all decisions; vetoes only apply to certain types of decisions that have been clearly defined in the articles of association.<sup>1052</sup> The CO does not specify any material restrictions in relation to when a veto can apply.<sup>1053</sup> However, veto rights can lead to a deadlock in decision-making and should therefore only be applied prudently.<sup>1054</sup> For example, if approval of the annual statement is subject to a veto, this can lead to an inability to take other decisions.<sup>1055</sup>

#### (d) *Removal of Managing Directors*

330 Another regulation governing LLCs that compromises the clear distribution of competences are the remedies for removing a managing director. The members' general meeting may remove a managing director whom it has appointed at any time,<sup>1056</sup> even when the managing director has been appointed for a fixed period of time.<sup>1057</sup> Managing directors who were not appointed but are managing members on account of their membership status or the articles of association<sup>1058</sup> can only be removed by changing the articles of association to include a rule specifying that management must be appointed by the members'

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<sup>1049</sup> VON PLANTA, p. 70.

<sup>1050</sup> BÖCKLI, GmbH-Recht, p. 27.

<sup>1051</sup> NATER, p. 101.

<sup>1052</sup> AB N 2005, p. 101; Botschaft GmbH 2002, p. 3209; DUC, p. 93; CR CO II, CHAPUIS, par. 3; NUSSBAUM/SANWALD/SCHWEIDEGGER, par. 13; SIFFERT ET AL., par. 10; who have a less strict interpretation.

<sup>1053</sup> BSK II-TRUFFER/DUBS, Art. 807, par. 4.

<sup>1054</sup> CHAPPUIS, p. 48, CR CO-CHAPPUIS, Art. 807, par. 3; HANDSCHIN/TRINIGER, § 11 par. 25; NUSSBAUM/SANWALD/SCHWEIDEGGER, Art. 807, par. 2; OLIVAR PASCUAL/ROTH, ST 6-7/2007, pp 470; §; SIFFERT ET AL., Art. 807, par. 2.

<sup>1055</sup> TRUFFER/DUBS, Art. 807, BSK II, par. 2.

<sup>1056</sup> Art. 815 par. 1 CO. For companies limited by shares, Art. 705 CO (Art. 705 revCO).

<sup>1057</sup> BSK II-WATTER, Art. 815 par. 5.

<sup>1058</sup> Art. 809 par. 1 CO.



meeting.<sup>1059</sup> This is necessary because management enjoys established and vested rights that can only be revoked by amending the articles of association.<sup>1060</sup>

### (e) *Transfer of Competences?*

Thanks to the flexible parity system in limited liability company law, the competence to create and release reserves may be transferred to another organ – management – without causing significant changes to the overall distribution of competences. The flexible parity system ensures that there are a lot of control mechanisms that give the members' meeting the right to intervene in the management of a LLC. Additionally, an instrument of partial transfer of competences according to Art. 811 CO is already known in the LLC regulations. Finally, the transfer of mandatorily allocated competences is prohibited<sup>1061</sup> and a transfer of the competence to create and dissolve reserves is admitted.

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## (2) *Management / Executive Committee*

### (a) *Remedies*

In case the members' meeting decides on a distribution of profit that does not comply with the CO, management must challenge this decision in order to avoid being held liable for an illegal decision.<sup>1062</sup> A decision by the member's meeting is challengeable if it violates the law, general principles or the articles of association.<sup>1063</sup> In contrast to decisions by the members' meeting, decisions by management may only be challenged in the case of nullity.<sup>1064</sup> This difference gives management another remedy to intervene in and control the decision-making process.

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<sup>1059</sup> Botschaft 2002, p. 3216; see also BGE 81 II 545; SENTI, *AJP*, 1/2011, p. 19. Furthermore, any company member may request the court to revoke or restrict the right of a managing director to manage or represent the company where there is good cause, in particular if the person concerned has seriously breached his obligations or is no longer able to manage the company competently, as per Art. 815 par. 2 CO.

<sup>1060</sup> BSK II-WATTER, Art. 815 par. 9.

<sup>1061</sup> Botschaft 2002, p. 3174.

<sup>1062</sup> HANDSCHIN/TRUNINGER, § 9 par. 36 and § 5 par. 31 et seqq.

<sup>1063</sup> The dynamic reference relates to the right to challenge or declare nullity, BSK II-TRUFFER/DUBS, Art. 808c, par. 1 and 4; ZK-VON STEIGER, Art. 808 par. 13.

<sup>1064</sup> A nullity suit, as per Art. 816 CO; WOHLMANN, p. 104.

(b) *Subsidiary General Competences*

333 As with companies limited by shares, management is responsible and competent for all matters not assigned to the members' meeting by law or by the articles of association.<sup>1065</sup> The aim of this article is to avoid either a positive competence conflict or a negative competence conflict that would result in no organ being competent.<sup>1066</sup> In order to do so, it is crucial that the managers are obligated to manage the company;<sup>1067</sup> delegation to individual managing directors or another organ is not allowed.<sup>1068</sup> The competences described in the following subsections are very closely related to those required for the formation of reserves; as such, management is the most appropriate organ to decide on the formation and release of reserves.

(i) *Overall Management*

334 Overall management involves taking measures to instruct and oversee individual managers, authorised signatories or authorised officers.<sup>1069</sup> It is only the duties relating to overall management of an LLC – and not its day-to-day management – that are inalienable and irrevocable; as long as they do not involve fundamental decisions, the tasks of day-to-day management can be delegated.<sup>1070</sup> Overall management is more concerned with overseeing the business management strategy than with the specifics of its implementation.<sup>1071</sup>

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<sup>1065</sup> BSK II-WATTER/ROTH/PELLANDA, Art. 810 par. 2 and 6 CO; Art. 810 par. 2 CO is almost identical to Art. 716a par. 1 CO in the section of the law on companies limited by shares, which can thus also be consulted for purposes of interpretation. Cf. Expertenbericht zum VE, p. 38.

<sup>1066</sup> Botschaft 2002, p. 3212; SIFFERT/FISCHER/PETREIN, Art. 810 par. 2; NUSSBAUM/SANWALD/SCHWEIDEGGER, Art. 810 par. 2.

<sup>1067</sup> Cf. HANDSCHIN/TRUNINGER, § 13 par. 149; NATER, p. 148.

<sup>1068</sup> For companies limited by shares, see: STÖCKLI, p. 584.

<sup>1069</sup> Cf. BSK II-WATTER/ROTH/PELLANDA, Art. 810 par. 7.

<sup>1070</sup> NATER, p. 149.

<sup>1071</sup> Cf. BSK II-WATTER/ROTH/PELLANDA, Art. 810 par. 7.

*(ii) Organisation*

Organisation includes the structuring of the company as well as organisation of administrative tasks and personnel.<sup>1072</sup> As such, determining the organisational structure of the executive organ as well as deciding on possible delegations of authority are the exclusive competences of management.<sup>1073</sup> However, the members' general meeting must appoint a chairperson if a company has two or more managing directors,<sup>1074</sup> although it can deviate from this regulation via the articles of association and transfer this competence to management.<sup>1075</sup> 335

*(iii) Organising the Accounting*

Responsibility for the finances of an LLC is subdivided into three areas by the CO: accounting, financial control and financial planning.<sup>1076</sup> Management's primary responsibility is to pass resolutions and thus take decisions, while permanent supervision is only a secondary responsibility.<sup>1077</sup> This does not mean that management is directly involved in the execution of the corresponding tasks; instead its role is to determine strategic guidelines and oversee the implementation thereof.<sup>1078</sup> It is important to note here that the formation or release of reserves may not fall under the scope of the organisation of finances, since reserves are explicitly mentioned in the new legislation on companies limited by shares as a competence of the general assembly.<sup>1079</sup> Although decisions on whether to create or dissolve reserves could fall under the scope of financial strategy, the legislation on LLCs generally corresponds to that for companies limited by shares. As such, like for companies limited by shares, the creation and dissolution of reserves appears not to fall under the scope of financial decision-making. 336

<sup>1072</sup> NATER, p. 151; for company law, see: BSK II-WATTER/ROTH PELLANDA, Art. 716a par. 10; KAMMERER, p. 149; Art. 809 par. 3 CO.

<sup>1073</sup> NATER, p. 152; for company law, see: BSK II-WATTER/ROTH PELLANDA, Art. 716a par. 10; KAMMERER, p. 151; MEIER-SCHATZ, ST 69/1995, p. 824.

<sup>1074</sup> Art. 809 par. 3 CO.

<sup>1075</sup> WOHLMANN, pp 131 et seqq.

<sup>1076</sup> Art. 810 par. 2 no. 3. CO.

<sup>1077</sup> SIFFERT/FISCHER/PETRIN, Art. 810 par. 8 et seqq; BSK II-WATTER/ROTH PELANDA, Art. 810 par. 9.

<sup>1078</sup> SIFFERT/FISCHER/PETRIN, Art. 810 par. 8 et seqq.

<sup>1079</sup> See Art. 673 revOR (Art. 672 CO).

(iv) *Supervision*

- 337 In case the managing directors have appointed managers, authorised signatories or authorised officers, they need to be supervised, in particular to ensure their compliance with the law, articles of association, regulations and directives.<sup>1080</sup> 810 par. 2 no. 4. CO differs slightly from the equivalent Art. 716a par. 1 no. 5 CO in the legislation on companies limited by shares, with the latter mentioning “overall supervision” and not only “supervision”. In comparison to the role of the executive of LLCs, this article was intended to allow the board of directors of companies limited by shares greater and more extensive powers of delegation and more of an opportunity to concentrate on its supervisory functions.<sup>1081</sup> Bearing in mind that the concept of management used by LLCs is originally based on that for self-integrated companies, in which all members are managing members, this conclusion make sense.<sup>1082</sup>

(v) *Annual Report*

- 338 Responsibility for the annual report<sup>1083</sup> is closely related to the responsibility for financial accounting<sup>1084</sup> and thus also for the creation and dissolution of reserves. The preparation of the annual report is not an inalienable and irrevocable power; indeed, while it is explicitly stated that management has the responsibility to ensure that the annual report is compiled, preparation thereof may be undertaken by an individual manager or an external actor and, as such, can be delegated.<sup>1085</sup>

(c) *Delegation*

- 339 The regulations governing LLCs provide for two different management models. On the one hand, management can be undertaken by an individual managing director or a group of managing directors;<sup>1086</sup> alternatively, management

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<sup>1080</sup> Cf. SIFFERT/FISCHER/PETRIN, Art. 810 par. 11.

<sup>1081</sup> MEIER-HAYOZ/FORSTMOSER/SETHE, Gesellschaftrecht 2012, § 18 par. 21.

<sup>1082</sup> Cf. WATTER/ROTH/PELLANDA, Art. 810, par. 10. See also Art. 809 CO.

<sup>1083</sup> Incorporating the annual accounts, the management report and, if applicable, the consolidated accounts; Art. 810 par. 2 no. 5.

<sup>1084</sup> Cf. BSK II-WATTER/ROTH PELLANDA, Art. 810, par. 11.

<sup>1085</sup> NATER, p. 155.

<sup>1086</sup> Or a committee. NUSSBAUM/SANWALD/SCHIEDEGGER, Art. 804 par. 3.

duties can be delegated to one or more third-party non-members<sup>1087, 1088</sup>. Both of these forms of delegation involve a downwards reallocation of competences.<sup>1089</sup>

### (i) Notion

Absent for LLCs is a regulation on the delegation of business management duties<sup>1090</sup> that is similar to the rule applicable to companies limited by shares.<sup>1091</sup> However, an obligation for management to delegate responsibilities can also be derived for LLCs from the duties of care and loyalty, especially in cases where a division of work is necessary.<sup>1092</sup> Based on Art. 809 par. 1 sentence 2 in combination with Art. 776a par. 2 no. 7 CO (in force until 31 December 2022),<sup>1093</sup> the doctrine acknowledges that delegation can also apply to LLCs.<sup>1094</sup> This form of delegation must be distinguished from the competence to approve resolutions as described above:<sup>1095</sup> delegation is an assignment of competences to another organ for its exclusive decision-making authority,<sup>1096</sup> both however, are based on the articles of association and contain a transfer of competences. Delegation must also be distinguished from an attraction of competences, by which the members' general meeting can grant itself competences by amending the articles of association.<sup>1097</sup> The doctrine differentiates between two types of delegations: a delegation of competences, by which a

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<sup>1087</sup> Managers, authorised signatories or authorised officers.

<sup>1088</sup> Art. 776a par. 2 no. 7 CO (in force until 31 December 2022); HANDSCHIN/TRUNIGER, § 10, par. 1.

<sup>1089</sup> Alternatively, this can also occur upwards to the members' meeting; see NATER p. 189.

<sup>1090</sup> Explicitly Art. 716b CO.

<sup>1091</sup> PLÜSS, SJZ 94/1998, p. 313.

<sup>1092</sup> Art. 812 par. 1 CO. For companies limited by shares see VON DER CRONE, Arbeitsteilung, p. 79; ROTH PELLANDA, par. 493.

<sup>1093</sup> In the revOR, Art. 775 will be removed. Although article with the conditional matters which must be included in the articles of association will be abandoned, no material changes are intended. Botschaft 2016, p. 607.

<sup>1094</sup> HANDSCHIN/TRUNIGER, § 14 par. 21; SIFFERT/FISCHER/PETRIN, Art. 809, par. 3; BSK II-WATTER/ROTH PELLANDA, BSR II, Art. 809 par. 6; BÖCKLI, GmbH-Recht, p. 31.

<sup>1095</sup> See [Paragraph 323](#).

<sup>1096</sup> Cf. NATER, p. 185.

<sup>1097</sup> Cf. NATER, p. 185.

power belonging to management is transferred in its entirety to another organ, and the delegation of the competence to decide on a specific question with the aim of passing a resolution thereon.<sup>1098</sup>

(ii) *Requirements*

- 341 For a delegation of competences, a resolution by the members' general meeting is not sufficient; a clause in the articles of association that permits – but does not obligate – the delegation of specific competences is needed.<sup>1099</sup> Management has the sole authority to invoke a delegation clause but is not obligated to do so,<sup>1100</sup> an indirect delegation via the articles of association is not possible.<sup>1101</sup> Hence, cooperation between the members' general meeting and management is required for any delegation to take place.<sup>1102</sup>

(iii) *Subdelegation*

- 342 A subdelegation or delegation of delegations occurs when an original competence of the members' general meeting is delegated once again from the managing directors to a manager. This downwards<sup>1103</sup> delegation is possible for all duties that are not inalienable and irrevocable, as per Art. 810 par. 2 CO.<sup>1104</sup> Furthermore, the delegation of business management duties is permitted.<sup>1105</sup> As the authority to form and release reserves is an original competence of the members' general meeting,<sup>1106</sup> it is not listed as a non-transferable competence of management. The question arises whether a competence that has already been transferred downwards from the members' general meeting to the managing directors may be transferred downwards once again to a third-party manager. Here, the further question of which organ or individual is more spe-

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<sup>1098</sup> Ibid.

<sup>1099</sup> Ibid., p. 185 et seqq. FORSTMOSER, SZW 66/1994 p. 172.

<sup>1100</sup> It is important to note that management remains liable for its decision and responsible for instruction and supervision (*cura in eligendo, instruendo et custodiendo*). HANDSCHIN/TRUNIGER, § 14 par. 22; BSK II-WATTER/ROTH/PELLANDA, Art. 809, par. 6; BÖCKLI, GmbH-Recht, p. 31.

<sup>1101</sup> NATER, p. 187. For companies limited by shares, see: BÖCKLI, Aktienrecht, § 13 par. 524.

<sup>1102</sup> NATER, p. 186. For companies limited by shares, see: FORSTMOSER, Eingriffe, p. 172.

<sup>1103</sup> Or upwards to the members' meeting.

<sup>1104</sup> HANDSCHIN/TRINIGER, § 10, par. 29; cf. BSK II-WATTER/ROTH/PELLANDA, Art. 810, par. 5.

<sup>1105</sup> SIFFERT/FISCHER/PETRIN, Art. 809, par. 3; HANDSCHIN/TRUNIGER, § 14 par. 21; BSK II-WATTER/ROTH PELLANDA, Art. 809 par. 6.

<sup>1106</sup> Or the general assembly for companies limited by shares: Art. 672 CO (Art. 673 revCO).

cialised in financial accounting is decisive when answering the question of whether a delegation of the competence to create and dissolve reserves is possible.

### (3) *Admissibility of a Delegation?*

After this overview of the distribution of power in LLCs, the question of whether the members' meeting has the competence to create and release voluntary reserves can be answered. We have seen that the annual accounts are prepared by management but need to be approved by the members' meeting, while the allocation of balance sheet profit also requires the final approval of the members' meeting. In LLCs, management's position is weak and subject to numerous checks and balances by the members' meeting. In contrast to companies limited by shares, LLCs do not have a board of directors that selects and removes the managers, a responsibility which falls to the members' meeting as per Art. 815 CO. Finally, decisions on profit distribution fall under the authority of the members' meeting; however, although the ultimate approval of the members' meeting is still needed, management is permitted to create and release open reserves as well as voluntary reserves if allowed to do so by the articles of association. As such, delegation of the competence to create and release reserves is possible; given that the members' meeting is the supreme body of a LLC, this would be classified as a downwards delegation. Especially in the case of LLCs, the articles of association grant the members' meeting huge discretion to adapt to the needs of an individual company. Moreover, the law governing LLCs permits the articles of association to specify that management must submit certain decisions to the members' general meeting for approval, as per Art. 811 CO. At first glance, such a regulation relating to the financial accounting is not necessary, since the general meeting has the inalienable and non-transferable competence to approve the financial accounting. However, the advantage of Art. 811 par. 1 no. 1 CO is that specific aspects of the financial accounting may be approved by the general meeting in advance, while the general assembly may subsequently approve the financial accounting *ex toto* as per Art. 804 par. 2 no. 5 CO.

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Furthermore, delegated competences can be delegated once again from management to an individual manager with more specialised skills. However, the aim of the legislation is to ensure that each organ retains its competences as much as possible. What is admissible for a board of directors with wide and

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extensive powers of delegation ultimately also applies to LLCs, whose managing directors only have a supervisory function. Moreover, there is no restriction that would prohibit a sub-delegation.

### 1.3. Cooperatives

345 As mentioned above in relation to reserves for companies limited by shares, cooperative law does not contain a norm with a reference to the limited liability regulations like in the LLC regulations.<sup>1107</sup> Cooperative law includes its own regulations for the allocation and formation of reserves and welfare funds in Art. 860 et seqq CO, while Art. 862 CO and Art. 863 CO provide for further allocations to the reserve fund. Generally, the financial accounting rules are applicable across all legal forms; however, as there are some peculiarities to the different legal forms outlined in cooperative law, the competence to form and release reserves must be analysed from a fresh perspective for each form.<sup>1108</sup> The rights and obligations of cooperatives are very different from those of companies limited by shares. This means that the legal status of the respective members differs, which in turn has an impact on the functions of the general assembly and the administration or management. It is also important to bear in mind that cooperative law has not undergone a revision since the first half of the twentieth century.<sup>1109</sup>

#### 1.3.1. Specific Characteristics

346 Although the specific characteristics of cooperatives generally do not favour a delegation, there are arguments for why they could be compatible with a delegation.

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<sup>1107</sup> See [Paragraph 314](#).

<sup>1108</sup> Cf. MAYER- MAYOZ/FORSTMOSER/SETHE, § 19, par. 10.

<sup>1109</sup> Revisions took place in 1919 and 1936; Cf. *Ibid.*, § 19, par. 117 and 184 et seq.



## (1) *Nominal Capital*

For cooperatives, a minimum nominal capital requirement is optional<sup>1110</sup> due to their person-based structure, which stands in contrast to that of capital-based entities.<sup>1111</sup> However, in case there is a minimum nominal capital requirement, it is mandatory that this remains flexible or amendable.<sup>1112</sup> 347

A minimum nominal capital requirement is only possible if the “open doors principle”<sup>1113</sup> is respected and there are thus no restrictions on new members.<sup>1114</sup> In this case, a minimum capital limit must be included in the articles of association.<sup>1115</sup> Nominal capital does not have the same importance for cooperatives as for companies limited by shares, but the protection of nominal capital is very similar for both types of entity: the liability base is secured through the nominal capital as well as through the reserves.<sup>1116</sup> 348

## (2) *Nature of the Entity*

In contrast to companies limited by shares and LLCs, cooperatives are defined in Art. 828 par. 1 CO as cooperative entities.<sup>1117</sup> The person-based or democratic structure of cooperatives is demonstrated by the “one person, one vote” principle, which disregards the number of shares owned by the members.<sup>1118</sup> This person-based structure also shapes the legal status of the members, since Art. 828 par. 1 CO defines a cooperative’s primary purpose as promoting and safeguarding the individual financial interests of its members by way of collective self-help.<sup>1119</sup> 349

<sup>1110</sup> Art. 828 par. 2 CO; ZK-GUTZWILLER, Art. 828 par. 34 and 39; MAYER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 40 et seq.

<sup>1111</sup> TAISCH/TROXLER, Eigenkapitalbeschaffung, in AJP 2013/3, p. 408; see also Art. 828 par. 2 in conjunction with Art. 833 no. 1 CO and Art. 853 par. 1 CO.

<sup>1112</sup> Consequently, for the creditors, a minimum nominal capital requirement does not represent a security in terms of a liability equity base as it does in companies limited by shares law. Cf. BSK II-BAUDENBACHER, Art. 828 par. 26; MAYER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 41 et seq.

<sup>1113</sup> EHLEBRACHT translates this principle as Button-Up structure that also includes the cooperative’s democratic nature. EHLEBRACHT, p. 17.

<sup>1114</sup> BSK II-BAUDENBACHER, Art. 828 par. 27.

<sup>1115</sup> ZK-GUTZWILLER, Einl. par. 99 et seqq.

<sup>1116</sup> MAYER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 43 et seq.

<sup>1117</sup> BSK II-BAUDENBACHER, Art. 828 par. 5.

<sup>1118</sup> Cf. Art. 885 CO; BGE 67 I 262.

<sup>1119</sup> MAYER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 6 and 16.

### 1.3.2. Rights of the Members

#### (1) *Legal Status of the Members*

350 Unlike a company limited by shares, for which membership is based on capital contributions, membership of a cooperative is person-based: the members' financial rights and obligations are not a requirement of membership, but rather the result thereof.<sup>1120</sup> This absolute equality stands in stark contrast to the status of shareholders in companies limited by shares.<sup>1121</sup>

#### (2) *Equality and Voting*

351 Their equal legal status ensures that all members of a cooperative have the same rights and obligations.<sup>1122</sup> Any revocation of the right to vote with reference to the articles of association or another decision is to be considered void and a violation of the members' equality.<sup>1123</sup> The rights of the members to participate in the affairs of the cooperative, in particular in relation to the management of the business and the promotion of its interests, are exercised by participating in the general assembly of members.<sup>1124</sup> This norm illustrates how important the participation of individual members in the decision-making process of cooperatives is in the eyes of the legislation.<sup>1125</sup> As such, even when a member cannot form part of the administration/board of directors, he or she can at least participate in and vote in the general assembly.<sup>1126</sup> The right to vote is specified in two articles: Art. 885 CO and Art. 855 CO, with the latter emphasises the principle of "one person, one vote".<sup>1127</sup>

#### (3) *Distribution of Net Profit*

352 The rules on the allocation of reserves depend on whether a net profit is distributed or whether it is allocated to the cooperative's assets.<sup>1128</sup>

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<sup>1120</sup> MAYER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 68.

<sup>1121</sup> HENGGELER, p. 169.

<sup>1122</sup> Cf. Art. 854 CO.

<sup>1123</sup> BSK II-NIGG, Art. 854 par. 15; see also BGE 69 II 41 and BGE 131 II 459.

<sup>1124</sup> Art. 855 CO.

<sup>1125</sup> CHK-COURVOISIER, Art. 855 par. 2.

<sup>1126</sup> BSK II-NIGG, Art. 855 par. 1; see Art. 879 et seq. CO. As stated in Paragraph 322 for LLCs, the revised CO also states in Art. 879 par. 2 no. 3<sup>bis</sup> revCO for cooperatives that the decision about repaying capital is a non-transferable competence.

<sup>1127</sup> Cf. BSK II-NIGG, Art. 855 par. 1.

*(a) No Distribution*

According to Art. 859 par. 1 CO, any net profit arising from a cooperative's business operations passes in its entirety to its assets. Generally, net profit is not distributed because the aim of a cooperative is to benefit its members, not to distribute profit.<sup>1129</sup> This allows net profit to contribute to the self-financing<sup>1130</sup> of the cooperative and to the development of its business activities.<sup>1131</sup> This results in an accumulation of assets, a situation which is clearly preferred over distribution by the CO, as reflected by the order in which these options are listed.<sup>1132</sup> 353

*(b) Distribution*

The articles of association may permit a distribution of net profit in proportion to the use of the cooperative's facilities by individual members, unless the articles of association stipulate another distribution rule.<sup>1133</sup> This main distribution rule, which does not consider members' capital contributions, corrects any inflation of the facilities' prices caused by the net profit, thereby ensuring that they remain at self-help levels.<sup>1134</sup> As a result, members benefit directly through using the cooperative's facilities and indirectly by receiving a distribution of profit.<sup>1135</sup> Finally, the CO contains additional rules in relation to shares: the portion of the net profit paid out on them must not exceed the usual rate of interest for long-term loans without special security.<sup>1136</sup> In such cases, a capital-based form of distribution is allowed but within clearly defined limits.<sup>1137</sup> 354

<sup>1128</sup> BSK II-NEUHAUS/BALKANYI, Art. 859 par. 3.

<sup>1129</sup> Cf. *Ibid.*, Art. 859 par. 2.

<sup>1130</sup> Another – but less commonly used – financing option is to issue share certificates, as per Art. 859 par. 3; TAISCH/TROXLER, *Eigenkapitalbeschaffung*, AJP 2013/3, p. 408.

<sup>1131</sup> MAYER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 88.

<sup>1132</sup> NÖSBERGER, ST 2/2012, pp 19; see also TAISCH/TROXLER, *Eigenkapitalbeschaffung*, AJP 2013/3, p. 408.

<sup>1133</sup> Art. 859 par. 3 CO.

<sup>1134</sup> NEUHAUS/BALKANYI, BSK II, Art. 859 par 3 et seq; MAYER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 90; NÖSBERGER, ST 2/2012, pp 19.

<sup>1135</sup> NÖSBERGER, ST 2/2012, pp 20.

<sup>1136</sup> Art. 859 par. 3 CO.

<sup>1137</sup> MAYER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 92 et seq; MONTAVON ET AL., § 15, par. 171. See the different rule for credit cooperatives in [Paragraph 384 et seqq](#) below.

### 1.3.3. General Assembly

355 The description of the general assembly as the supreme body also applies to cooperatives.<sup>1138</sup> Generally, the parity principle is also applicable to the general assembly of a cooperative.<sup>1139</sup> Norms grounded in the law governing companies limited by shares have been rephrased to reflect the clear division between these two types of entities, but many other norms are not based on companies limited by shares law.<sup>1140</sup> Unlike companies limited by shares, with cooperatives there is no presumption of competence in favour of the administration, thereby illustrating the importance of the general assembly for the democratic structure of cooperatives.<sup>1141</sup>

#### (1) *Expansion of Competences by the Administration*

356 An expansion of competences may be allowed in cooperatives with more than 300 members or when the majority of members are themselves cooperatives.<sup>1142</sup> At first sight, this would appear to contradict the entrenched and pronounced democratic structure of a cooperative's general assembly, but ultimately this does allow for a minimum level of democratic decision-making even while expanding the competences of the administration.<sup>1143</sup> According to these exceptions to the usual distribution of competences, the articles of association may stipulate that all or some of the powers of the general assembly are to be exercised by ballot, as per Art. 880 CO, or by an assembly of delegates, as per Art. 892 CO.

#### (a) *Ballot*

357 A ballot replaces the general assembly's decision-making process when the members vote in writing without holding a general assembly.<sup>1144</sup> As debate and discussion between the members does not occur when a ballot is held, this lack of participation by the members can lead to an unrepresentative deci-

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<sup>1138</sup> BSK II-TRUFFER/DUBS, BSK OR II, Art. 804 par. 8.

<sup>1139</sup> MAYER-HAYOZ/FORSTMOSER/SETHE, *Schweizerisches Gesellschaftsrecht*, § 19, par. 120; BSK II-MOLL, Art. 879, par. 5.

<sup>1140</sup> HENGGELER, p. 4.

<sup>1141</sup> MAYER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 121.

<sup>1142</sup> Cf. DRUEY/DRUEY JUST, *Gesellschafts- und Handelsrecht*, § 19, par. 33.

<sup>1143</sup> Art. 880 CO; WEBER-DÜRLER, p. 100.

<sup>1144</sup> WEBER-DÜRLER, p. 100.

sion.<sup>1145</sup> As such, use of a ballot comes with disadvantages<sup>1146</sup> and is viewed critically, since a decision-making process in the truest sense of the term is not possible.<sup>1147</sup>

### (b) *Assembly of Delegates*

Through an assembly of delegates, the general assembly of a cooperative can be completely or partially replaced with a parliamentary-like process,<sup>1148</sup> thereby constituting a downgrade from direct to indirect democracy.<sup>1149</sup> Unlike for companies limited by shares, an assembly of delegates is permitted for cooperatives,<sup>1150</sup> which is surprising given the importance that the legislation places on democratic decision-making in cooperatives. Ultimately, an assembly of delegates allows for a transfer of power from the members to the administration.<sup>1151</sup> 358

### (2) *Decision-Making*

As described in the chapter on the rights of cooperative members, the “one person, one vote” principle and its attendant democratic decision-making process is fundamental to cooperatives. While representation by proxy is common in companies limited by shares, this only occurs on a very restricted basis in cooperatives.<sup>1152</sup> Only another member may act as a proxy for a member, and no proxy may represent more than one member.<sup>1153</sup> Cooperatives, as person-based entities, thus place significant emphasis on the decision-making powers of their own members. 359

<sup>1145</sup> BSK II-MOLL, Art. 880 par. 9.

<sup>1146</sup> BGE 67 I 342 consideration 3.

<sup>1147</sup> ZK-GUTZWILLER, Art. 880, par. 5; GERBER, pp 270 and p. 275.

<sup>1148</sup> Cf. DRUEY/DRUEY JUST, *Gesellschafts- und Handelsrecht*, § 19, par. 35.

<sup>1149</sup> MEIER-HAYOZ/FORSTMOSER/SETHE, § 19 par. 128.

<sup>1150</sup> BGE 128 III 142 E. 3b; VON DER CRONE, § 5 par. 57; MEIER-HAYOZ/FORSTMOSER/SETHE, § 16 par. 529.

<sup>1151</sup> Cf. DRUEY/DRUEY JUST, *Gesellschafts- und Handelsrecht*, § 19, par. 33.

<sup>1152</sup> MEIER-HAYOZ/FORSTMOSER/SETHE, § 19 par. 126.

<sup>1153</sup> Art. 886 par. 1 CO. See par. 3, which allows the articles of association to reserve the right to permit the representation of a member by a family member. Cf. HENGGELER, p. 168.

### (3) *An Inalienable Competence?*

360 Despite the predominant understanding of democratic decision-making in co-operatives, the list of the general assembly's inalienable<sup>1154</sup> competences is much shorter than the equivalent list for companies limited by shares; even in very democratically structured entities, the "most important business operations" must be entrusted to a small executive decision-making body, such as the administration.<sup>1155</sup>

#### (a) *Profit Distribution*

361 For cooperatives, the approval of the management report and the consolidated accounts are listed under the general assembly's inalienable powers.<sup>1156</sup> In the section on the rights and obligations of cooperative members, the obligation of the general assembly to approve the management report, the consolidated accounts and the annual accounts is systematically described in the context of the deadlines that the general assembly must meet.<sup>1157</sup> Additionally, the new financial accounting regulations stipulate that the annual report must also be submitted to the responsible management body or managers for approval.<sup>1158</sup> The fact that profit distribution is not mentioned in either rule gives rise to a loophole. This should be closed with a comparable norm from the law on companies limited by shares, according to which the general assembly must approve the management report, the consolidated accounts and the use of profit.<sup>1159</sup> The question of profit orientation and, as such, the distribution of dividends is less important for cooperatives, whose main priority is to contribute to collective self-help.<sup>1160</sup> The intention of the legislation is reflected in the dividends restriction in Art. 859 CO, as discussed above.<sup>1161</sup> The creation of

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<sup>1154</sup> See BGE 67 I 262 consideration 1; BGE 97 II 108, the articles of association can even prohibit the participation of another organ in an association.

<sup>1155</sup> See Art. 698 and 879 CO; DRUEY/DRUEY JUST, *Gesellschafts- und Handelsrecht*, § 19, par. 32.

<sup>1156</sup> Art. 879 par. 2 no. 3 CO.

<sup>1157</sup> Art. 856 par. 1 CO.

<sup>1158</sup> Art. 958 par. 3 CO.

<sup>1159</sup> Cf. Art. 698 par. 2 no. 4 CO, Art. 804 par. 2 no. 5, Art. 879 par. 2 no. 3 CO and Art. 879 par. 2 no. 3<sup>bis</sup> revCO e contrario; ZIHLER, *veb.ch Praxiskommentar*, Art. 958, par. 21.

<sup>1160</sup> Cf. HENGGELER, p. 14.

<sup>1161</sup> BSK II-BAUDENBACHER, Art. 828 par. 18.

these reserves is *dependent on* whether the net profit was distributed to the members or allocated to the cooperative's assets,<sup>1162</sup> as will be discussed in the following subsection.

(b) *Allocation to the Reserves*

(i) *Statutory Reserves*

As long as the net profit is allocated to the assets and not distributed to the members, a cooperative does not have to make an allocation to the reserve fund. This means, in other words, that this allocation is not mandatory but voluntary,<sup>1163</sup> in contrast, when the net profit is distributed or used for other purposes, allocation to the reserves is mandatory.<sup>1164</sup> Hence, cooperative law differs from companies limited by shares law, according to which allocation to the reserves is mandatory regardless of whether or not a distribution has been made.<sup>1165</sup> I argue that this difference is appropriate because of the contrasting characteristics and legal natures of the two types of entities.

Art. 879 par. 2 no. 1-4 CO (Art. 879 par. 2 no. 2<sup>bis</sup> and no. 3<sup>bis</sup> revCO) contains the non-alienable (or inalienable) powers, additionally no. 5 states that the passing of resolutions concerning matters that have been reserved for the general assembly by law or by the articles of association also belong to the listed non-alienable powers. Regarding the competence to form reserves, this could mean that the power to form and release reserves could become a non-alienable power through the articles of association. Contrary to the wording in par. 2, these competences of the general assembly are non-alienable like those mentioned in no. 5, and can be transferred to other organs by amending the articles of associations.<sup>1166</sup> For example, the competence in Art. 863 par. 1 CO to make further allocations to the reserves is reserved by law for the general assembly.<sup>1167</sup> This means that when deemed appropriate in order to secure the long-term financial health of a cooperative, the general assembly may also de-

<sup>1162</sup> Cf. BSK II-NEUHAUS/BALKANYI, Art. 859 par. 3.

<sup>1163</sup> The terminology has remained the same as in the former legislation for companies limited by shares.

<sup>1164</sup> Art. 860 par. 1 CO. See also Art. 863 par. 1 CO. GERWIG argues that cooperatives always need to make an allocation to the reserves. See GERWIG, pp 221 et seqq.

<sup>1165</sup> Cf. BSK II-BALKANYI, Art. 860 par. 3 seq.

<sup>1166</sup> BSK II-MOLL, Art. 879 par. 33.

<sup>1167</sup> Other examples are: Art. 834 par. 3; Art. 846 par. 3; Art. 849 par. 1; Art. 857 par. 2; Art. 874 par. 1, Art. 890, Art. 911 no. 2 CO; see BSK II-MOLL, Art. 879 par. 33.

cide to create reserves that are not envisaged by or do not meet the high requirements of the law or the articles of association.<sup>1168</sup> Based on this norm, it is possible to form reserves based on a resolution by the general assembly<sup>1169</sup> or reserves based on the articles of association, as will be shown in the next subsection. Additionally, the revised law mentions with no. 2<sup>bis</sup> a move towards the company limited by shares and in no. 3<sup>bis</sup> allows repayment of capital reserves (Art. 879 par. 2 revCO).

(ii) *Allocations as per the Articles of Association*

364 The articles of association may allow for further allocations, according to Art. 860 par. 2 CO. Moreover, Art. 862 CO offers the option of forming welfare funds, which are also reserves that are aimed at establishing and financing funds, in particular those dedicated to the welfare of the cooperative's employees as well as its members. Art. 860 CO and Art. 862 do not allocate this competence to one organ; only the amendment of the articles of association is required. Based on both norms, the general assembly may through the articles of association delegate the competence to form such reserves to another organ, such as the administration.

(c) *Delegation of Competences?*

365 As shown, decisions on the use of net profit are an inalienable competence of the general assembly; however, if such a decision involves the formation of reserves, a delegation of this competence is possible for other reasons than in the company limited by shares and the LLC.<sup>1170</sup> While cooperatives are based on the "one person, one vote" principle of direct democracy, the extension of decision-making powers to the administration via a ballot and the assembly of delegates is permitted. Both result in a lowering of the genuinely democratic quality of the decision-making. Corresponding to this regulation, which at first glance thus seems to run counter to the democratic nature of a cooperative, the competence to create and release reserves may be delegated to the ad-

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<sup>1168</sup> Art. 863 par. 2 CO; BSK II-NEUHAUS/BALKANYI, Art. 860 par. 10.

<sup>1169</sup> BSK II-NEUHAUS/BALKANYI, Art. 860 par. 10.

<sup>1170</sup> There is no similar Art. 716 par. 1 CO. It's more a case-by-case question. BK-FABRIZIO, § 3 par. 65.



ministration by amending the articles of association.<sup>1171</sup> Here, the administration should be considered the most appropriate body for the formation as well as the release of reserves because of its knowledge and experience of the tasks of management.

### 1.3.4. The Administration or Board

The administration<sup>1172</sup> is the managing body of a cooperative.<sup>1173</sup> The position and function of the administration in a cooperative mirrors that of the management in a company limited by shares. The rules for cooperatives, however, are not identical to those for companies limited by shares; as such, cooperative law does not simply refer to the corresponding regulations for companies limited by shares. Instead, it is reproduced afresh to take into account relevant differences in the nature of cooperatives.<sup>1174</sup> For the question of delegation, the ways in which cooperative law deviates from the legislation on companies limited by shares is decisive.

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#### (1) Collegial Management

In cooperative law, there are two special mandatory rules in relation to management. First, the board of directors of a cooperative must consist of at least three persons.<sup>1175</sup> Second, a majority of the board of directors must be members.<sup>1176</sup> However, the articles of association may allow for a larger collegial government.<sup>1177</sup> Additionally, the articles of association may require that all members be directors.<sup>1178</sup> The legislation demonstrates how important per-

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<sup>1171</sup> However, upon closer look, this democratic nature is not strictly implemented as can be seen by looking at instruments like the ballot and the assembly of delegates. Therefore, this work argues that a delegation is permitted if the *demos* (Greek for citizens, population; here the majority) is convinced to *cratere* (Latin for take a decision, decide). Here, the question may arise how the absolute equality (of this population) may be interpreted in the next (coming) revision, and if this could be an impediment to a delegation, which in this work is not disputed. See for the latter BK-FABRIZIO, § 3 par. 96.

<sup>1172</sup> The CO still uses the older term “administration” rather than “board of directors”, MEIER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 132.

<sup>1173</sup> WOLFER, pp 48 et seqq; VON STEIGER, pp 50 et seqq; DRUEY/GLANZMANN, § 19 par. 32 et seqq.

<sup>1174</sup> Cf. BSK II-WERNLI/RIZZI, Art. 894, par. 1a.

<sup>1175</sup> Art. 894 par. 1 CO.

<sup>1176</sup> Art. 894 par. 2 CO. Third parties are allowed but within restrictions, Cf. BSK II-BAUDENBACHER, Art. 828 par. 5.

<sup>1177</sup> BSK II-WERNLI/RIZZI, Art. 894, par. 5.

<sup>1178</sup> ZK-GUTZWILLER, Art. 894, par. 10.

sonal relations are in cooperatives. Due to the unique characteristics of these entities, cooperative law is much stricter than the equivalent rules for companies limited by shares.<sup>1179</sup> The consequences thereof are also apparent in relation to the allocation of the competence to create and release reserves, especially as this relates to the questions of which body should be assigned the competence to create and dissolve reserves and whether the competence to create and dissolve reserves should be allowed to be delegated in a cooperative.

### (2) Competences

368 A presumption of competences<sup>1180</sup> similar to that which applies to companies limited by shares is absent from cooperative law. As a result, the question of which competences belong to the general assembly and which belong to the administration must be resolved for each individual competence.<sup>1181</sup> Furthermore, unlike for companies limited by shares or LLCs, there is no list of inalienable powers that applies to cooperatives.<sup>1182</sup> However, competences that have not been explicitly assigned to the administration/management belong to the general assembly.<sup>1183</sup> In relation to the competence to create and release reserves, the CO explicitly assigns this competence to the general assembly without stipulating whether this is an inalienable power. As such, the competence to create and release reserves is generally considered transferable. The CO repeats the allocation rules individually for cooperatives, demonstrating that the small contextual differences are crucial and that they could not have been applied by referring to the equivalent regulations in companies limited by shares.

### (3) Delegation

369 Although a delegation norm is absent from cooperative law, unlike in company law,<sup>1184</sup> parts of the doctrine allow for a delegation of competences to a committee, the directors or the managers via the articles of association.<sup>1185</sup> Accord-

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<sup>1179</sup> BSK II-WERNLI/RIZZI, Art. 894, par. 7a.

<sup>1180</sup> Art. 716 par. 1 CO.

<sup>1181</sup> WOLFER, pp 36 and 41.

<sup>1182</sup> Art. 716a CO.

<sup>1183</sup> See [Paragraph 351](#).

<sup>1184</sup> Art. 716b CO.

<sup>1185</sup> WOLFER, pp 69 et seq and 75 et seq. See also the examples of delegated competences.

ing to another opinion on the doctrine,<sup>1186</sup> it is unclear whether delegation is admissible, while CAPITAINE disputes the admissibility of delegation altogether.<sup>1187</sup> Given that there is no delegation norm in cooperative law, it has also been argued that the fundamental principle of collegial management is without legal basis and that it should thus be abolished.<sup>1188</sup> Although companies limited by shares law could be applied by analogy to the question of the scope of the delegation powers in cooperatives,<sup>1189</sup> this would not apply if there is no legal basis for delegation in the first place. The administration may expand its competences and power through a ballot or by establishing an assembly of delegates if the general assembly is willing to amend the articles of association accordingly.

#### (4) *Delegation of a Delegated Competence?*

The question of whether a sub-delegation – in this case, the competence to create and release reserves – is permissible can be answered in the affirmative. No regulation was found that explicitly prohibits this, nor would such a regulation correspond with the options available to companies limited by shares or LLCs. The articles of association must take into consideration the democratic nature of cooperatives. Moreover, any decision to include or exclude a delegation clause in the articles of association will be the result of a democratic decision by the meeting. As such, although the CO clearly differs from company law on the question of collegial management by placing tight restrictions on delegation powers, these regulations can be amended by the meeting.

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<sup>1186</sup> MEIER-HAYOZ/FORSTMOSER/SETHE, *Eigenkapitalbeschaffung bei Genossenschaften*, § 19, par. 132.

<sup>1187</sup> Cf. CAPITAINE, ZBJV 3/1953, pp 106 et seq.

<sup>1188</sup> MEIER-HAYOZ/FORSTMOSER/SETHE, § 19, par. 133.

<sup>1189</sup> DRUEY/DRUEY JUST/GLANZMANN, *Gesellschaft und Handelsrecht* § 19 par. 31 et seqq.



## 2. Banking Sector

In the banking sector, delegation via the articles of association is not necessary because the option already exists to create reserves for general banking risks. This chapter analyses the inherent characteristics of banking companies, which justify the use of reserves for general banking risks. 371

### 2.1. Bank Categories

The Banking Act was enacted in 1936 in parallel to the revision of the CO. Consequently, the Banking Act is oriented towards the CO, especially towards the regulations of companies limited by shares.<sup>1190</sup> The main legal category of bank is that of the company limited by shares,<sup>1191</sup> followed to a lesser extent by the cooperative,<sup>1192</sup> for which some special norms apply in Art. 11–14b Banking Act.<sup>1193</sup> Generally, major banks<sup>1194</sup> are not restricted in terms of the legal form that they can take.<sup>1195</sup> In contrast, private banks<sup>1196</sup> and cantonal banks can only exist in specified legal forms.<sup>1197</sup> Cantonal banks may operate as a public sector institution or as a company limited by shares.<sup>1198</sup> Generally, banks take the form of a company limited by shares, as per Art. 620 et seqq CO, a mixed economy company limited by shares (a public-private company limited by shares), as per Art. 762 CO, or a public limited company (special statutory public limited company), as per Art. 763 CO.<sup>1199</sup> 372

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<sup>1190</sup> NOBEL, Finanzmarktrecht, § 7, par. 45.

<sup>1191</sup> Art. 620 et seqq CO. The special norm in the former Art. 5 BankG was removed.

<sup>1192</sup> Art. 828 et seqq CO.

<sup>1193</sup> See Finanzmarkt-Lexikon-THALMANN, p. 887.

<sup>1194</sup> Like UBS and Credit Suisse, cf. [www.swissbanking.org](http://www.swissbanking.org) (last accessed: 15/01/2021).

<sup>1195</sup> KUNZ, p. 101; NOBEL, Finanzmarktrecht, § 7, par. 265.

<sup>1196</sup> See Art. 1 BankG.

<sup>1197</sup> See Finanzmarkt-Lexikon-THALMANN, p. 887.

<sup>1198</sup> Art. 3a BankG.

<sup>1199</sup> BK-NOBEL, § 5, par. 60. See for an overview of authorized banks and securities firms: <https://www.finma.ch/en/finma-public/authorised-institutions-individuals-and-products/> (last accessed: 15/01/2021).

## 2.2. Selected Categories of Banks

### 2.2.1. Companies Limited by Shares – Banks

#### (1) *The Banking Act as lex specialis*

373 The CO was applicable to banks until the Banking Act entered into force.<sup>1200</sup> However, both federal acts still contain rules for banks that operate in the form of a company limited by shares, the respective applicability of which must be resolved.<sup>1201</sup> A circular by the Swiss Federal Banking Commission (CFB),<sup>1202</sup> a body which no longer exists, stipulates that any conflict between rules or cases of overlapping applicability must be resolved on a case-by-case basis using the principle of *lex specialis* or that of *lex posterior*.<sup>1203</sup> As such, when the rules in the Banking Act differ from the newer law on companies limited by shares in the CO, *lex specialis* applies and the CO is not applicable,<sup>1204</sup> unless the CO's rules are newer and more precise.<sup>1205</sup> However – in casu – the question arises whether the banking-sector has newer and, in particular, stricter rules than the non-banking sector.

#### (2) *Dual Corporate Governance*

374 The parity principle requires a separation of powers between the general assembly and the board of directors in the non-banking sector. In the banking sector, this is even stricter and more entrenched: Where the business purpose or scope of business so requires, the bank must create separate bodies for its management on the one hand and for its direction, supervision and control on the other hand; these bodies must be adequately segregated in order to ensure the effective supervision of the bank's management.<sup>1206</sup> Due to the priority that

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<sup>1200</sup> See Botschaft 1934, p. 176.

<sup>1201</sup> EMMENEGGER/GEIGER, p. 15.

<sup>1202</sup> Replaced by FINMA.

<sup>1203</sup> Former EBK-Circ 93/1 par. 2 and notes to the EBK-Circ 93/1 no. 3; See FINMA-Circ 17/01: Corporate Governance – Banks, par. 9 (for the board of directors) and par. 47 (for the executive board).

<sup>1204</sup> NOBEL, Aktienrechtsreform, p. 173; cf. EMMENEGGER, pp 183 et seqq; cf. EMMENEGGER/GIGER, 19 et seq.

<sup>1205</sup> BERNET, p. 209; ISELI, § 5 par. 514. According to NOBEL the *lex specialis* is applicable unless the *lex posterior*, the revised company by shares regulations are stricter. See BK-NOBEL, § 5, par. 68; NOBEL, Aktienrechtsreform, pp 171 et seq; see also EMMENEGGER, p. 149.

<sup>1206</sup> Art. 3 par. 2 lit. a BankG.

the Banking Act enjoys over the CO, management's choice of delegation is not possible.<sup>1207</sup> According to Art. 716b CO (Art. 716b revCO), the board of directors may delegate the business management. However, the Banking Act also stipulates that management and the board, as the body which supervises management, must remain separate.<sup>1208</sup> Furthermore, no member of the board of directors may serve within management at the same time.<sup>1209</sup> Hence, banks are required to maintain a functional as well as a personal separation between the board and management.<sup>1210</sup> This separation of powers as well as the proscription on personal union both serve to improve the quality of supervision and to avoid a concentration of powers or a possible abuse of power.<sup>1211</sup> As such, these organisational rules ultimately serve as protection for the creditors.<sup>1212</sup>

### (3) *Transferability of the Board's Competences*

The CO describes the board of directors' inalienable competences in a list,<sup>1213</sup> while for banks a description of the board's competences is contained in a general clause in the Banking Act that covers overall management, supervision and control.<sup>1214</sup> Thus, the Banking Act provides an initial strict separation of competences, but the CO then concretises the competences of a bank's board of directors and classifies them as non-transferable, a categorisation which is not provided in the Banking Act.<sup>1215</sup>

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### (4) *Financial Accounting*

As shown below, organisation of the accounting – including the financial control and financial planning systems – falls under the non-transferable competences of a bank's board of directors.<sup>1216</sup> However, according to KLEINER/

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<sup>1207</sup> ISEL, § 5 par. 519.

<sup>1208</sup> Art. 3 par. 2 lit. a BankG. See FINMA-Circ 17/01: Corporate Governance – Banks, par. 9 (for the board of directors) and par. 47 (for the executive board).

<sup>1209</sup> Art. 8 par. 2 BankV; cf. BSK II-WATTER/ROTH PELANDA, Art. 716b par. 2.

<sup>1210</sup> BSK BankG-WINZELER, Art. 3 par. 8.

<sup>1211</sup> ZOBL/SCHWOB/WINZELER/KAUFMANN/WEBER/KRAMER, BankG-Kommentar, Art. 3 par. 61.

<sup>1212</sup> Cf. Botschaft 1934, p. 176.

<sup>1213</sup> Art. 716a par. 1 CO (Art. 716a par. 1 revCO).

<sup>1214</sup> Art. 3 par. 2 lit. a BankG; See FINMA-Circ 17/01: Corporate Governance – Banks, par. 9 (for the board of directors) and par. 47 (for the executive board).

<sup>1215</sup> EMMENEGGER, p. 215; EMMENEGGER/GEIGER, pp 45 et seqq.

<sup>1216</sup> Art. 716a par. 1 no. 3 CO.

SCHWOB, financial accounting, especially in the banking sector, is a technical competence that should fall under business management, from where it could then be transferred to overall management.<sup>1217</sup>

- 377 In contrast, ISELI sees financial accounting as an “inalienable” or “non-transferable” competence, the fundamental features of which must be exercised by the board of directors itself.<sup>1218</sup> As is also applicable for companies limited by shares in the non-banking sector, as described in [Paragraph 303](#), the organisation of the financial accounting is the responsibility of the board of directors, but the detailed reporting, which requires technical knowledge, should be delegated to a manager. In any case, the option outlined in Art. 716a par. 2 CO remains, according to which the board of directors may assign responsibility for preparing and implementing its resolutions or monitoring transactions to committees or individual members.

### (5) *Presumption of Competences*

- 378 In the non-banking sector, a (negative) presumption of competences in favour of the board of directors applies for competences that are not allocated by law, by the articles of association or by an organisational regulation.<sup>1219</sup> In the banking sector, the board of directors is responsible for overall management and supervision according to Art. 3 par. 2 lit. a BankG as well as Art. 716a par. 1 CO. Due to the separation of powers in Art. 3 par. 2 lit. a BankG, this presumption of competences cannot simply be assumed to apply in the same form for banks as in the form that applies to companies limited by shares with more restricted competences. Hence, before a presumption of competences is applied, it must be examined whether an unallocated competence may be a management competence, which is not permitted to be performed by the board of directors, but rather is a mandatory duty of management.<sup>1220</sup>

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<sup>1217</sup> ZOBL/SCHWOB/WINZELER/KAUFMANN/WEBER/KRAMER, BankG-Kommentar, Art. 3 par. 48.

<sup>1218</sup> ISELI, § 5 par. 530.

<sup>1219</sup> See [Paragraph 300](#).

<sup>1220</sup> However, the board has the competence to allocate unallocated competences. EMMENEGGER/GEIGER, pp 50. See also ISELI, § 5 par. 543.



## (6) Use of Profit

After the FINMAG came into force, the former Art. 5 of the Banking Act was repealed, making the CO<sup>1221</sup> applicable to the regulation of the use of profit.<sup>1222</sup> Whereas the Banking Act required a stricter protection of capital, a rule relating to the release of reserves, as in Art. 671 par. 3 CO, allowing the reserves to cover losses or to be used in crisis situations, was absent.<sup>1223</sup> It was precisely this wording that was also removed from the new Art. 671 revCO. 379

Through this change, the rules on the use of profit in the banking sector approached those for the non-banking sector, since the articles on the use of profit in the CO are applicable to both sectors. In a second step, the new CO also stipulates that “the general reserves may only be used to cover losses or for measures designed to sustain a company through difficult times, to prevent unemployment or to mitigate the consequences thereof”.<sup>1224</sup> As a result, while the general assembly in the non-banking sector loses the option of creating a type of risk reserves, the board of directors in the banking sector is allowed to create reserves for general banking risks. There is thus a need to make use of the opportunity provided by Art. 672 CO (Art. 673 revCO) to allow for the use of reserves based on the articles of association in the non-banking sector in order to fill this gap. 380

### 2.2.2. Cooperative Banks

#### (1) General Considerations

The cooperative bank is an alternative to the capital-based system of the company limited by shares bank. Similar to cooperatives, cooperative banks are based on collective self-help, solidarity and democratic decision-making.<sup>1225</sup> Banking cooperatives are all merged under the umbrella of the cooperative group Raiffeisenbanken,<sup>1226</sup> which has the densest bank subsidiary network in Switzerland, a reflection of the confidence which customers are prepared to 381

<sup>1221</sup> Art. 671 CO.

<sup>1222</sup> BSK II-NEUHAUS/BALKANYI, Art. 671 par. 45.

<sup>1223</sup> EMMENEGGER/GEIGER, p. 81.

<sup>1224</sup> Art. 5 BankG (2007). Initially, it was moved to the notes no. 15 of the FINMAG (2007).

<sup>1225</sup> Cf. NOBEL, Finanzmarktrecht, § 7 par. 254; cf. TAISCH, pp 98.

<sup>1226</sup> Friedrich Wilhelm Raiffeisen, ARPAGAUS/STADLER/WERLEN, par. 87.

place in this type of bank.<sup>1227</sup> Since 2014, Raiffeisen has been classified as a system-relevant bank and must therefore comply with additional equity and liquidity requirements as well as have an emergency plan.<sup>1228</sup>

## (2) *Banking Act*

382 Before the revision of the Banking Act, commercial banks were explicitly forbidden from operating as cooperatives.<sup>1229</sup> But with the cooperative having become, at least to a limited extent, a legal form of bank, the Banking Act – in Art. 11-14b BankG – now contains some additional rules for cooperative banks.<sup>1230</sup> The new option available to cooperative banks, as system-relevant banks, to issue participation capital will strengthen their equity and eliminate the market disadvantage that they previously had in comparison to company limited by shares banks.<sup>1231</sup>

## (3) *Addendum: Corporate Governance?*

383 It was described above how the parity principle is applied in limited liability companies<sup>1232</sup> and how this differs in cooperative law.<sup>1233</sup> With Raiffeisen having become a system-relevant bank, KUNZ's criticism that the limited liability company is more appropriate than the cooperative as a legal form for banks appears valid.<sup>1234</sup> This issue of a conversion from a cooperative to company limited by shares was also alluded to by the Financial Market Supervisory Authority due to the significant impact that a bank's legal form and structure has on corporate governance requirements.<sup>1235</sup> The main problem for a cooperative bank may be a lack of adequate oversight or control over the CEO by the

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<sup>1227</sup> In 2017, this included 255 cooperatives with 930 subsidiaries. See for an overview and more details [www.raiffeisen.ch/web/raifesebanken](http://www.raiffeisen.ch/web/raifesebanken) (last accessed: 15/01/2021).

<sup>1228</sup> NOBEL, Finanzmarktrecht, § 7 par. 256; Cf. Bericht des Bundesrates zu den systemrelevanten Banken vom Juni 2017.

<sup>1229</sup> See old Art. 13 BankG; BSK II-NEUHAUS/BALKANYI, Art. 861 par. 4a.

<sup>1230</sup> BSK BankG-WINZELER, Art. 3 par. 8.

<sup>1231</sup> Botschaft 2015, p. 153.

<sup>1232</sup> See [Paragraph 284 et seqq.](#)

<sup>1233</sup> See [Paragraph 345 et seqq.](#)

<sup>1234</sup> Tagblatt Online, 2/3/2018, Raiffeisen-Verwaltungsrat schlägt zurück, (last accessed: 12/11/2018, see NOBEL, Finanzmarktrecht, § 7, par. 256).

<sup>1235</sup> FINMA's Press Release of 14 Jun 2018, Raiffeisen: major corporate governance failings, p. 4. See <https://www.finma.ch/de/news/2018/06/20180614-mm-raiffeisen/> (last accessed: 15/01/2021).

board of directors.<sup>1236</sup> For example, Raiffeisen's board of directors failed in its duties as the body responsible for overall management, supervision and financial control.<sup>1237</sup> Raiffeisen's CEO had significantly built up the bank's shareholdings, with the result that Raiffeisen Switzerland was simultaneously a shareholder, business partner and creditor of numerous companies or their executive bodies as well as a representative on their boards. This led to a conflict of interest that caused Raiffeisen to be exposed to a high level of risk.<sup>1238</sup>

#### (4) Credit Cooperatives

Cooperatives can take the form of either credit cooperatives, which are subject to the Banking Act, or cooperatives that are not subject to the Banking Act due to Art. 5 par. 2 lit. f Banking Ordinance, which exempts cooperatives that have no activities in the financial services or banking sector and whose only purpose is self-help.<sup>1239</sup> The CO provides additional rules on how credit cooperatives are to distribute net profit or allocate to the reserves.<sup>1240</sup> 384

##### (a) Profit Distribution

For credit cooperatives, the CO provides an exception to the restrictions<sup>1241</sup> on net profit distribution, an exception which also applies to other cooperatives.<sup>1242</sup> Additionally, according to the general rules for cooperatives, net profit distribution may be abrogated, as is also the case for capital-based companies limited by shares.<sup>1243</sup> Consequently, the rule that net profit must be distributed in proportion to use of the cooperative's facilities may be abrogated based on Art. 861 par. 1 CO.<sup>1244</sup> 385

<sup>1236</sup> Ibid., pp 1 and 3.

<sup>1237</sup> Ibid., p. 3.

<sup>1238</sup> Ibid., p. 2.

<sup>1239</sup> NOBEL, Finanzmarktrecht, § 7 par. 254.

<sup>1240</sup> See Art. 861 CO; BSK II-NEUHAUS/BALKANYI, Art. 861 par. 1.

<sup>1241</sup> Art. 859 par. 3 CO is not applicable to credit cooperatives.

<sup>1242</sup> See Art. 861 par. 1 CO; cf. BSK II-NEUHAUS/BALKANYI, Art. 861 par. 6. Thus, the regulations are stricter. BK-KILGUS, § 4 par. 39.

<sup>1243</sup> BSK II-NEUHAUS/BALKANYI, Art. 861 par. 5 et seqq; see the historical discussion ZK-GUTZWILLER, Art. 861 par. 7 et seq.

<sup>1244</sup> ZK-GUTZWILLER, Art. 861 par. 6; MEIER-HAYOZ/FORSTMOSER/SETHE, § 19 par. 159.

(b) *Creation and Dissolution of Reserves*

386 The rules for credit cooperatives on allocations to the reserves deviate from the usual rules for cooperatives.<sup>1245</sup> The first allocation must adhere to the rule that at least one-tenth of the net profit must be allocated to the reserve fund until the value thereof is equal to one-tenth of the cooperative's nominal capital.<sup>1246</sup> The rule for the second allocation is:<sup>1247</sup> Where a portion of the net profit is paid out to holders of shares in the cooperative and that portion exceeds the usual rate of interest for long-term loans without special security, one-tenth of the amount by which it exceeds the usual interest rate must likewise be allocated to the reserve fund.<sup>1248</sup> The general rules for cooperatives are applicable for the dissolution and use of reserves.<sup>1249</sup>

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<sup>1245</sup> Cf. Art. 861 par. 2 CO.

<sup>1246</sup> Art. 861 par. 2 CO; BSK II-NEUHAUS/BALKANYI, Art. 861 par. 8.

<sup>1247</sup> BSK II-NEUHAUS/BALKANYI, Art. 861 par. 9.

<sup>1248</sup> Art. 861 par. 3 CO.

<sup>1249</sup> BSK II-NEUHAUS/BALKANYI, Art. 861 par. 10.

## Preliminary Conclusion and Results to Part II

The parity principle is deeply anchored in the structure of companies limited by shares. According to this principle, the general assembly and the board of directors both have inalienable competences and enjoy equal status. In contrast, the omnipotence theory does not have primacy in the CO, although it is mentioned. In addition to its inalienable competences, the general assembly has additional powers, such as the competence to form and release reserves. Furthermore, it has the competence to allocate itself as of yet unallocated competences, while the board of directors has a subsidiary general competence for unallocated competences. This clear manifestation of the parity principle is relativised slightly by the fact that the general assembly can, as the electing or appointing electing body, dismiss the appointed management without reason, whom it can thus pressure with the threat of sanction. 387

The general assembly's inalienable competences are divided between the competence to approve (i.e. to accept or reject a proposal submitted by the board) and the competence to decide (i.e. to take material decisions with a full scope of discretion). "Approval competences" include approval of the management report, the annual accounts and decisions on the distribution of profit, all of which are very closely related to the competence to create and dissolve reserves. On the other hand, allocation to the reserves as well as the power to determine and amend the articles of association are full "decision competences". 388

Finally, conflicts can arise, such as between the shareholders' right to receive a dividend, as per Art. 660 par. 1 CO, and the general assembly's authority to approve decisions on profit distribution. However, the CO continues to provide a clear hierarchy in the new Art. 673 revCO, according to which the creation of reserves is prioritised over the shareholders' interest in receiving a share of the profit in the form of a dividend. Only after the initial allocation to the reserves, which is a competence of the general assembly, may the board of directors prepare or propose a distribution of profit, which once again must be approved by the general assembly. However, the general assembly may allow for deviations from this rule via the articles of association, because Art. 673 par. 3 revCO contains the limits of such a delegation and restricts an abusive use, since the shareholders' interest should be considered when creating reserves. 389

390 As such, the creation of reserves involves an interplay between both bodies, based on which it is possible to conclude that a transfer of the competence to create reserves from the general assembly to the board of directors does not materially undermine the relativised parity principle; indeed, delegation favours this very interplay, hence it corresponds to the purpose of the norm. Finally, delegation is based on amending the articles of association, which represents an inalienable competence that in turn allows the general assembly to transfer its competence to create reserves to the board of directors without losing its competence to approve profit distribution. Furthermore, the general assembly maintains its ability to exert pressure on and sanction the board of directors. As such, it can be concluded that a delegation by the general assembly by means of the articles of association is admissible. The articles of association should clearly describe the scope within which the board of directors may allocate reserves. For example, the articles of association could specify concrete risks to be countered by delegation, as is also done for reserves for general banking risks. Delegation could also be tied to another specific condition or restricted to a limited period of time. Alternatively, the board of directors may be given full discretion to decide when to allocate reserves if the articles of association are amended accordingly.

391 The board of directors also has a remedy available if one of its competences is usurped or if a decision taken by the general assembly is in violation of the law or the articles of association. The board of directors possesses a subsidiary general competence, a negative presumption of competences in its favour that should not be underestimated considering that the general assembly only takes decisions once per year – and then only based on the requests and information submitted by board of directors. The board of directors is charged with acting in the long-term interest of the entity by making complex strategic decisions, while the shareholders have a short-term interest and may sell their shares at any time when their financial interests are no longer being served. Corresponding to the long-term role of the board of directors are its non-transferable competences, which cannot be transferred upwards to the general assembly nor downwards to management. The board's main non-transferable power is that of overall management, which incorporates business strategy, oversight and risk management. Further competences are the main features without the details of organisation, the organisation of the accounting as well as the financial control and financial planning, the appointment and dismissal of managers entrusted with management duties, overall supervision, and the preparation of the annual report. All these competences are related both to the creation of hidden reserves, which the board of directors has the

competence to create and dissolve, and to the issue of the further delegation of a competence that has already been transferred from the general assembly to the board of directors. The members of the board of directors share collective responsibility and a personal union between the board and the management is allowed in the non-banking sector. The board of directors may delegate its transferable competences – those relating to business management – to more specialised managers, a situation which is often especially necessary in larger companies. A delegation of the general assembly's competence to form and release reserves requires an empowerment by the general assembly and the passing of a corresponding organisational regulation by the board. This competence may be delegated to an individual member of the board, since a personal union is allowed, or to a third party if checks and balances are guaranteed. As such, a delegation of a delegation is admissible: the board's competences may be delegated to a more specialised manager as long as the competence in question involves executing the overall organisational strategy developed by the board of directors.

Fundamentally, this does not constitute a loss of authority for the general assembly, which must first permit such a delegation by means of the articles of association and then ultimately approve the financial accounting. 392

In a limited liability company, the same relationship applies between the general assembly and the board of directors as in a company limited by shares, but there is also an additional relationship between all the company members that generates additional responsibilities. 393

According to the CO, limited liability companies range from a very person-based form to a less person-based form. The very person-based is the usual LLC model, which is automatically applicable if there are no special amendments in the articles of association. According to this model, questions of which bodies have the competence to form and release reserves and whether a delegation thereof is possible are not relevant, since all the members are managing members. However, it shows a perfect solution of small self-integrated entity where every member has this duty. Only when a vote takes place does the question become relevant of whether the members are voting as members of an executive organ, in which their votes are counted per person, or under the auspices of the members' meeting, where the votes are counted in proportion to capital contribution. Finally, the members cannot absolve themselves of the responsibility by resigning unless this is permitted by the articles of association or this competence has been delegated to a third party. Expulsions are not possible in self-integrated companies. 394

395 Limited liability companies may also differentiate between managing members and non-managing members. However, since the parity principle is relativised in relation to companies limited by shares, solutions that are appropriate for the latter cannot be applied without modification to LLCs. Although decisions on profit distribution are a competence of the general assembly, a competence which may also include decisions on allocation to the reserves, the formation and release of reserves are newly mentioned in Art. 672 CO (Art. 673 revCO). Furthermore, because they are not listed under the non-transferable and inalienable competences, they are a transferable competence. As such, while the same mechanism applies in this regard for LLCs as for companies limited by shares, the manner in which competences can be delegated diverges significantly due to the relativised form of the parity principle that applies to companies limited by shares and which allows them to have more flexible delegation rules. In contrast, for LLCs: (1) the significance of allocated competences is limited by the requirement that resolutions be approved by the general assembly, either in the form of a mandatory approval or the optional right to approve individual resolutions; (2) the right of veto enjoyed by some members weakens the position of the other members and can result in a deadlock; (3) managing members appointed by the meeting may be dismissed at any time by the meeting. As such, this flexible allocation of competences with checks and balances allows for a transfer of competences that does not negatively impact the authority of the general assembly, which remains in a powerful position. Moreover, in contrast to companies limited by shares, an LLC does not have a board of directors that appoints and removes managers; this is the responsibility of the members' meeting.

396 Decisions taken by the management of an LLC, in contrast to those made by the members' general meeting, may only be challenged in case of nullity as per Art. 816 CO. Management has a subsidiary general competence to resolve positive or negative competence conflicts and enjoys both alienable and inalienable competences. This work examined the competences relating to the formation of reserves. It was demonstrated that management is the appropriate organ to decide on the formation and release of reserves. The other key question was whether management could transfer this competence to an individual manager or a third party. The following conclusions were reached: (1) overall management – including development and oversight of the overall business strategy and other decisions that are fundamental to the running of the company – cannot be delegated, but day-to-day management can be delegated; (2) “organisation” incorporates any decision on whether or not to delegate a competence; (3) oversight in an LLC is less important and desired by the legis-



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lator than in a company limited by shares, with less extended delegations as a result; (4) the financial accounting as well as the annual report – but not the detailed preparation thereof – are the responsibility of the managing directors, who have a duty to supervise both processes and any specialist managers involved therein.

Finally, the fundamental question relating to delegation can be answered. Although a delegation norm like that for companies limited by shares is absent from the doctrine, a delegation from the managing directors to an individual manager or a third party is permitted. For a delegation to occur, a minimum level of cooperation between the members' meeting and management is required. First, a delegation must be anchored in the articles of association, which are written by the members' meeting. Thereafter, the managers must decide whether they may make use of it or not. However, the delegation of a delegation – extended delegation or a redelegation – is not clearly permitted, as this would not correspond to the structure of an LLC as a self-integrated company. The legislator chose not to make provision for an extended delegation option to accompany the responsibility for overall supervision, as is the case for companies limited by shares, instead only stipulating its duty of overall supervision. This indicates that the legislation does not support a concentration of supervisory powers or a further delegation of competences originally belonging to the members' meeting. However, a delegation of the competence to form and release reserves may be very beneficial for the company by allowing specialists to play a role in this regard.

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Ultimately, the members' meeting remains in a strong position even after transferring the competence to form and release reserves due to the instruments of control that it retains, such as the right to approve decisions by management or to dismiss managers.

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In cooperatives, which prioritise collective self-help, the members' rights and obligations as well as their overall position are very strong, which has an impact on the allocation of competences. Since equality among the members is paramount, a nominal capital is optimal. The protection of capital functions in the same way as in a company limited by shares; as such, reserves also have the same function.

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The legislation emphasises the participation of every individual member of a cooperative. In the general assembly, the principle of “one person, one vote” is fundamental. The distribution of net profit is a members' fundamental right. This is also the case for the other types of company; however, in such an overtly person-based and democratic type of entity, the rights of the members

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appear to carry even more weight. Generally, net profit is not distributed but results in an accumulation of assets and serves as self-financing. The CO favours an accumulation of assets over distribution. When a distribution does occur, this must happen in proportion to the use of the cooperative's facilities by its members. Distribution thus constitutes an additional indirect advantage. When shares are distributed, this must occur within the limits stipulated in the CO.

401 As in a company limited by shares, the general assembly is the supreme decision-making body of a cooperative, while the parity principle is also applicable. However, unlike a company limited by shares and in order to avoid a conflict of competences, the CO does not presume that one body enjoys a presumption of competences. This difference has an impact on how competences are allocated. The administration can expand its competences by means of two instruments, namely a ballot or an assembly of delegates, both of which weaken the democratic decision-making processes of the general assembly. Generally, decisions in a cooperative are taken by its own members. Again, contrary to what would have been expected for a person-based and democratic entity and in contradiction of the principle of democratic decision-making, the list of inalienable powers belonging to the general assembly of a cooperative is shorter than the equivalent for a company limited by shares. This illustrates that even very democratically structured entities entrust an executive body with a high number of decision-making competences.

402 The general assembly is responsible for the approval of the management report and any profit distributions – if a distribution does indeed occur. Both of these competences are considered to be inalienable powers of the general assembly, although preparation may be carried out by the administration with, ultimately, only approval constituting the general assembly's inalienable competence. The general assembly is also explicitly responsible for reserves. In cooperative law, the CO requires an allocation to the reserves only when a net profit is distributed. If there is no distribution, an allocation to the reserves is optional. As such, allocation to the reserves depends largely on whether a net profit is distributed or not. This rule has clarified the question of competences. On the one hand, Art. 879 par. 5 CO states that passing resolutions on matters reserved to the general assembly by law or by the articles of association represents an inalienable power. Also in the previous Art. 674 par. 2 and 3 CO the general assembly was explicitly mentioned. However, in the revised Art. 672 CO the general assembly is not mentioned but is newly mentioned in revised Art. 673, which is ruling the reserves based on the articles of association. As the former articles ruling the reserves based on the articles of association was

systematically before Art. 674 CO which is systematically the first mentioning the general assembly it cannot be understood in the light of 674 CO. Therefore, allocation to reserves was a transferable competence because the general assembly was only mentioned later in Art. 674 CO. With the actual revised CO, no change regarding the competences was intended. The Botschaft do not say nothing; only the terminology was adapted. With regard to the competence no change was done with the revised Art. 673 revCO even though now it explicitly mentions the general assembly. Thus, the general assembly has the option of forming reserves based on a resolution. Furthermore, the general assembly may form reserves based on the articles of association, which in cooperatives are known as reserve funds. The articles of association may also provide for a delegation to the administration.

At first glance, it would seem that competences belonging to the general assembly should remain in the hands of the general assembly. However, a closer look at the rules governing cooperatives has shown that the CO's regulations on members' decision-making powers are not rigid; indeed, they often contradict the person-based and strictly democratic decision-making structure of cooperatives, which would otherwise disallow a delegation of the competence to form and dissolve reserves. As such, after closer inspection, delegation is also admissible in cooperatives, but for different reasons than in companies limited by shares. A delegation must occur in accordance with a cooperative's democratic structure, which as we have seen does allow for exceptions to or a curtailment of its most overtly democratic decision-making processes via a ballot and an assembly of delegates. However, the question of whether the administration is the appropriate body to be the recipient of a delegation of powers must still be examined. The administration, as the managing body, fulfils much the same role as management in a company limited by shares. However, unlike the regulations for LLCs, cooperative law does not simply refer to the corresponding regulations for companies limited by shares. Instead, the rules are repeated afresh, suggesting that deviations from these regulations should be considered in order to reflect the unique attributes of cooperatives.

The composition of the administration is based on strict rules relating to members' personal associations with the cooperative as well as to its democratic structure. The administration is composed of at least three directors, the majority of whom must be members of the cooperative; however, the articles of association may stipulate stricter terms in relation to the latter or require a larger administration. Unlike for companies limited by shares, there is no list of inalienable competences for cooperatives and no rule that presumes that unallocated powers belong to the administration. Finally, although the conven-

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tional delegation norm is missing in the CO, the general assembly may opt for a delegation based on the articles of association. Although a delegation could reduce the level of democratic decision-making, this is permitted for the same reasons that allow for a ballot or an assembly of delegates. Delegation has no legal basis in the CO, but it does have a democratic basis if included in the articles of association by the general assembly. The competence to form and release reserves belongs explicitly to the general assembly, but this may be delegated by means of the articles of association as the wording permits such a delegation and the competence is not listed as non-transferable. The articles of association could even be used to provide a legal basis for a sub-delegation. The competence may be delegated despite the person-based nature of cooperatives. Given that the members are completely free to amend or not amend the articles of association, there is no contradiction with the inherent characteristics of cooperatives: the members share an interest in collective self-help, the number of non-members in the administration is restricted, and the administration has no non-transferable duties. It is clear that the general assembly does enjoy a degree of supremacy, but ultimately this does not exclude a delegation based on the members' decision.

405 The following holds true for all forms of companies: both the board of directors and management are more directly involved in the accounting than the general assembly. If the articles of association do not allow the creation and dissolution of reserves, the board of directors will be more likely to form hidden reserves as no alternative instrument will be available. As such, this work supports a more liberal approach to the creation of reserves based on the articles of association, as per Art. 672 CO (Art. 673 revCO), combined with the right to delegate this power to a more specialised body.

406 After analysing the distribution of competences in the non-banking sector, the distribution of competences in banking companies limited by shares as well as in banking cooperatives, such as Raiffeisen, were analysed. The Banking Act is more recent than the CO, on which the former is thus based. Before the Banking Act entered into force, the CO was applicable to banks. According to Circular 93/1 of the old CFB, a body which has since been replaced by the FINMA, if two federal acts are applicable, a case-by-case analysis is needed to decide which law applies. Generally, the principle of *lex specialis* is applied, but when the CO has more specific and recent rules, *lex posterior* is applied subsidiarily. As such, the parity principle in the Banking Act is stricter in demanding a clear functional and personal separation between the board of directors and management. Consequently, Art. 716b CO (Art. 716b revCO), which allows for a delegation of the board of directors' business management competence, is not

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applicable. This means that better supervision as well as better protection against an abuse of power – and, ultimately, better protection of the creditors – is guaranteed. The board of directors is responsible for overall management and supervision, as per Art. 3 par. 2 BankG.

The Banking Act does not contain a list of the board of directors' inalienable powers and its non-transferability, and as a result the CO is used to concretise the more general Banking Act. The financial accounting, like in a non-banking company limited by shares, is thus not transferable, but the detailed reporting can be performed by a specialist manager; the board of directors, however, retains overall responsibility. Furthermore, the presumption of competences in favour of the board of directors is thus also not applicable in a banking company limited by shares. It remains to be examined whether a competence should be a mandatory management competence.

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Finally, a specific norm in the Banking Act existed in relation to the use of profit, but this was deleted when the FINMAG came into force. The previous wording of Art. 5 Banking Act had allowed for the release of reserves to cover losses or for undertaking measures for sustaining companies in difficult times. The revised Art. 671 revCO (Art. 671 CO) ruling reserves deleted the same wording for the non-banking company limited by shares. The first step to a convergence of the banking sector to the non-banking sector was the deletion of the Art. 5 Banking Act and the applicability of Art. 671 par. 3 CO. In a first step towards a convergence of the rules for the banking sector and the non-banking sector, the new Art. 671 par. 3 CO did not include this wording from the old Art. 5 Banking Act, meaning that the latter's rules could also no longer apply to non-banking companies limited by shares. In a second step, the non-banking sector lost the option of releasing reserves to cover losses or in support of measures to sustain a company in difficult times, a choice which is available to the banking sector in the form of reserves for general banking risks. In order to recreate the situation as it was before these changes came into effect, I argue that the use of reserves based on the articles of association should be permitted in the non-banking sector.

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The second category of bank that has been analysed is the cooperative bank. Cooperative banks merge to form cooperative groups, such as the system-relevant Raiffeisenbanken. The former Banking Act prohibited the existence of commercial cooperative banks. The current Banking Act, however, contains rules in Art. 11–14b that in particular apply to banking cooperatives and allow them, like banking companies limited by shares, to issue participation capital. As such, since the cooperative bank Raiffeisen is now classified as system-rel-

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evant and is permitted to issue participation capital in the same way as banking companies limited by shares, these two legal forms of bank have become very similar. However, the rules on corporate governance for companies limited by shares are much stricter in relation to parity, as a result of which the company limited by shares seems a more appropriate form for banks. In a cooperative, effective supervision and control by the board or the administration is thus crucial for ensuring a high level of corporate governance.

- 410 For credit cooperatives, the CO contains some special rules on net profit distribution and the allocation of reserves. The rule on distribution in Art. 859 par. 3 CO is overridden by Art. 861 par. 1 CO, which thus ensures that there are no restrictions on net profit distribution, unlike in other forms of cooperative. For the allocation of reserves, Art. 861 par. 2 CO stipulates that for the first allocation at least one-tenth of the net profit must be allocated to the reserve fund until the latter this is equivalent to one-tenth of the cooperative's nominal capital. In addition, when a distribution of profit has occurred, a second allocation equal to one-tenth of the amount by which it exceeds the usual rate of interest must be allocated to the reserve fund.
- 411 A closer look at the divergent regulations in the banking sector, however, still does not explain or justify why there is the option to create reserves for general banking risks – especially in light of peculiarities such as the rule in Art. 11 of the Banking Ordinance that requires a clear separation between overall business management and operational management. As such, the absence of a presumption of competences in favour of the board of directors has no impact on the question of reserves and does not justify the board of directors' competence to create reserves. The option of creating additional reserves for general banking risks, which allows the board of directors to create transparent – but not hidden – reserves is not based on any differences in corporate governance requirements. Indeed, since competences are more strictly allocated in the banking-sector, the opposite should apply, which would mean that no additional competences or reserves such as reserves for general banking risks would be permitted. Furthermore, the fact that reserves for general banking risks only exist in the banking sector – and not in the non-banking sector – cannot be explained either by the banking regulations or by the strict rules on cooperative governance that apply to banks.

### III. Effects of Reserves





## Preliminary Remarks to Part III

Part III will examine the effects of reserves in crisis situations as well as possible means of calculating capital loss and over-indebtedness, and the different points at which the authorities can intervene in such instances. For this analysis, the company limited by shares is used as a model for a comparison between the non-banking and banking sectors in order to illustrate the effects of reserves, provisions and reserves for general banking risks. 412

A further critical question focuses on the impact of the type of reserves proposed in this work – reserves based on the articles of association that include a transfer of competences – on corporate governance. As a concept that similarly involves an empowerment from the general assembly to the board, the capital band is used as a point of comparison. The same questions arise for both concepts, namely whether a transfer of competences from the general assembly to the board be achieved by means of the articles of association? Through stipulating a capital band in the articles of associations can the general assembly's competence to amend the capital level also be transferred to the executive body? The option to transfer the competence to change the capital level from the general assembly to the board of directors already exists in the banking sector. Both of these concepts could be critical from a corporate governance perspective, although they could also weaken the shareholders' rights. 413

Finally, a comparison with the Federal Supreme Court's judgment BGE 121 III 219 will be made due to the similar questions that arise in relation to the same question of delegation. In BGE 121 III 219, the articles of association permitted a delegation to the board of directors of the authority to restrict or revoke the shareholders' subscription right. 414



# 1. Capital Protection and Minimum Intervention Moments

The rules on capital protection and the point at which the authorities can intervene is different for non-banking companies limited by shares than for banking companies limited by shares. This difference may have an impact on the reserves and serves to emphasise their importance. 415

## 1.1. Company Limited by Shares

### 1.1.1. Non-Banking Companies Limited by Shares

The CO distinguishes between an initial instance of simple capital loss and a subsequent state of over-indebtedness.<sup>1250</sup> Only in the case of the latter must a company notify the authorities, in the form of a judge, as will be shown below. 416

#### (1) Capital Loss

##### (a) Calculation

The board of directors has the duty to supervise a company's financial situation; as such, the board of directors is responsible for calculating and determining capital losses.<sup>1251</sup> A capital loss is determined on the basis of the most recent annual balance sheet.<sup>1252</sup> However, if there is reason to notice a capital loss during the course of the year, the board of directors is not allowed to wait until the end of the financial year before reporting it, but rather must prepare an interim balance sheet.<sup>1253</sup> For the calculation of a capital loss, one-half of 417

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<sup>1250</sup> See Art. 725 et seqq CO. Art. 725rev et seqq CO will provide already measures by the board of directors already in the case of an impending insolvency and thus an earlier stage of intervention, which is prudent but for the question here not of importance as the measure is internal and not by an external authority, and therefore has no relevance for present question on moment of external intervention. See for the new option in Art. 725 revCO, VON DER CRONE, § 23, par. 1992 et seqq.

<sup>1251</sup> Art. 716a par. 1 no. 1 and 3 CO; ZK-HOMBURGER, par. 1198; CR CO II-PETER/CACADINI, par. 21; JACQUEMOUD/PASQUIER, SJ 10/2013, 278 et seqq. WIRZ, par. 19 et seqq.

<sup>1252</sup> Art. 725 par. 1 CO; BÖCKLI, Aktienrecht, § 13 par. 718.

<sup>1253</sup> ZK-BÜRGI, Art. 725 par. 4; SCHUCHANY, par. 1; BÖCKLI, Aktienrecht, § 13 par. 718.

the share capital and the full value of the all legal reserves is disregarded,<sup>1254</sup> and in the revised law, already in the case of Participation capital is classified as share capital, while the paid-in capital – and not the nominal capital – is counted.<sup>1255</sup>

(b) *Reserve Allowance*

418 Where the last annual balance sheet shows that one-half of the share capital and the legal reserves are no longer covered, the board of directors must without delay convene a general meeting and propose financial restructuring measures.<sup>1256</sup> For the calculation of a capital loss, only statutory reserves (accounting and legal reserves) are taken into account;<sup>1257</sup> a contrario, voluntary reserves are not considered.<sup>1258</sup> As a result, according to one opinion, reserves that are not permitted to be distributed as a dividend are excluded from this calculation.<sup>1259</sup> The question arises as to whether legal reserves should be considered as a whole or only the non-distributable part thereof.<sup>1260</sup> Thus, to the extent that legal reserves are not protected from distribution, they are not to be considered for this calculation.<sup>1261</sup> In contrast, BÖCKLI, also takes into account legal reserves whose distribution is not prohibited.<sup>1262</sup> Therefore, it is unclear whether or not a distinction should be made between disposable, protected and distributable reserves.<sup>1263</sup> The current wording is open and would permit both alternatives.

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<sup>1254</sup> See Art. 725 CO (Art. 725a par. 1 revCO).

<sup>1255</sup> ZK-HOMBURGER, par. 1201; ZK-BÜRGI, par. 5; LANZ, p. 35; SCHUCANY, par. 1; VON STEIGER, Art. 817 par. 2.

<sup>1256</sup> Art. 725 par. 1 CO. See the Art. 725a revCO which contained a lower threshold of only a third of the share capital, but also adds the legal reserves. Ultimately this option was refused. Cf. Botschaft 2016, p. 576.

<sup>1257</sup> BÖCKLI, Aktienrecht, § 13 par. 804 et seq. Hidden reserves, in particular, are not taken into account. BÖCKLI, Aktienrecht, § 13 par. 720b et seq.

<sup>1258</sup> GLANZMANN, Krisensituationen, p. 37.

<sup>1259</sup> Exclusion: ZK-HOMBURGER, Art. 725, par. 1204; VON SALIS, p. 4; ZK-HANDSCHIN, Art. 725 par. 66.

<sup>1260</sup> ZK-HANDSCHIN, Art. 725, par. 66; Inclusion: BÖCKLI, Aktienrecht, § 13 par. 718; KOEFERLI, p. 85 et seqq; WIRZ, par. 29, 33 and 34.

<sup>1261</sup> Cf. ZK-HOMBURGER, Art. 725, par. 1205 et seqq; CHAPPUIS, SJZ 4/2007, p. 87. See also Footnote 1244.

<sup>1262</sup> See the example calculations in BÖCKLI, Aktienrecht, § 13 par. 717, 724, 737 et seqq. See WIRZ for a statement of grounds for that opinion and a visualisation thereof. WIRZ, par. 29 et seqq.

<sup>1263</sup> See Botschaft 2008, pp 1661 par. 2.1.12.

As such, freely disposable reserves, as special reserves, as well as both the loss and the profit carried forward are not to be taken into account when calculating half of the capital loss.<sup>1264</sup> If the freely disposable reserves are not taken into account when calculating half of the capital loss, the saving measures are effectively accelerated and the moment of capital loss brought forward.<sup>1265</sup> While the new Art. 725a revCO originally aimed to lower the threshold to two-thirds of capital loss, half of capital loss was ultimately stipulated.<sup>1266</sup> Although it was not clarified whether this refers to the full legal reserves or only the non-distributable portion thereof, the revised Art. 725a revCO explicitly mentions the profit reserves and the capital reserves, both of which are not permitted to be used to pay out the shareholders. As the wording prior to the revision did not provide any further details and thus any further restrictions besides limiting pay-outs to those from the legal reserves, the opinion of BÖCKLI should be followed. Furthermore, since the revised law will correctly in Art. 725a par. 1 revCO explicitly mention the “non-distributable reserves”, it is obvious that only BÖCKLI must be followed.

Hence, voluntary reserves, as reserves based on the articles of association<sup>1267</sup> – which, as I argue in this work, may contain a transfer of competences to the executive body in order to create a risk reserve that follows the model of a reserve for general banking risks – are de lege lata not taken into account for the calculation of capital loss.

### (c) Measures

The board of directors must convene a general meeting if it wants to propose financial restructuring measures.<sup>1268</sup> The board is responsible for preparing these measures so that a decision thereon can be reached at the general assembly.<sup>1269</sup> The general assembly can only decide on measures which fall under its competences.<sup>1270</sup> Even if the board decides that no measures are possible, if the measures have already been introduced,<sup>1271</sup> or a creditor subordinates their claim as stated similarly according to Art. 725a par. 1 in fine revCO (Art. 725

<sup>1264</sup> BÖCKLI, Aktienrecht, § 13 par. 724.

<sup>1265</sup> BSK II-WÜSTINER, Art. 725 par. 18.

<sup>1266</sup> Botschaft 2016, p. 576.

<sup>1267</sup> See also GLANZMANN, Krisensituationen, p. 37.

<sup>1268</sup> Art. 725 par. 1 CO in fine.

<sup>1269</sup> BÖCKLI, Aktienrecht, § 13 par. 751.

<sup>1270</sup> HANDSCHIN, ZBJV 7/2000, p. 444.

<sup>1271</sup> JACQUEMOUD/PASQUIER, SJ 10/2013 II, p. 282.

par. 1 in fine CO), the board is not released from its duty to convene a general meeting.<sup>1272</sup> No resolutions may be passed on motions relating to agenda items for which there has been no due notification; as such, the notice convening the meeting must include the agenda items and the motions introduced by the board of directors.<sup>1273</sup>

422 The CO provides measures such as capital reduction and increase, liquidation, and the appointment of a new board of directors.<sup>1274</sup> Measures to counter a capital loss require the collaboration of the board of directors and the general meeting.

423 The shareholders must be informed of any such measures, as these have an impact on their financial rights, including their right to receive a possible liquidation receipt or dividend.<sup>1275</sup> Disclosure of hidden reserves must also be made to the shareholders immediately.<sup>1276</sup> Hence, the board has duties in cases of capital loss, while the general meeting has the right to decide on any proposed measures with a view to the financial rights and interests of the individual shareholders.

## (2) *Over-Indebtedness*

### (a) *Calculation of Over-Indebtedness and Reserves*

424 Over-indebtedness, which is determined on the basis of the interim balance sheet, occurs when the latter shows that the claims of the company's creditors are not covered<sup>1277</sup> – in other words, when the debt capital is greater than the value of the assets.<sup>1278</sup> Here, it is crucial that the share capital and the participation capital as well as the reserves and a possible profit carried forward are classified as equity.<sup>1279</sup> Depending on the classification of the reserves, there

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<sup>1272</sup> Cf. BÖCKLI, Aktienrecht, § 13 par. 803 et seq.

<sup>1273</sup> Art. 700 par. 1 and 3 CO.

<sup>1274</sup> BSK II-WÜSTINER, Art. 725 par. 25.

<sup>1275</sup> As long as a loss carried forward is shown on the balance sheet, a dividend cannot be claimed, LANZ, p. 78.

<sup>1276</sup> Cf. LANZ, p. 100; see BGE 121 III 420 for the shareholders' rights.

<sup>1277</sup> Regardless of whether the assets are appraised at going concern or liquidation values, Art. 725b revCO (Art. 725 par. 2 CO); ZK-HOMBURGER, Art. 725 par. 1235.

<sup>1278</sup> BSK II-WÜSTINER, Art. 725 par. 29.

<sup>1279</sup> BGE 47 III 97; ZK-VON STEIGER, Art. 817 par. 8.

are two possible definitions of over-indebtedness. Real over-indebtedness occurs when no equity remains after the dissolution of both open and hidden reserves.<sup>1280</sup>

In contrast, false over-indebtedness occurs when there is no equity on the books but there is additional equity in the form of hidden reserves.<sup>1281</sup> Rightly, the revaluation options that are contained in the actual Art. 670 CO (Art. 725c revCO), which effectively moderate and may ultimately resolve the problem of false over-indebtedness, have been moved to a more appropriate position in the new Art. 725c revCO.<sup>1282</sup> 425

### (b) Notifying the Courts

Unlike after a capital loss, there are no measures that the board of directors can institute to avoid its duty<sup>1283</sup> of notifying the courts of a state of over-indebtedness.<sup>1284</sup> When this occurs, the only means of saving the company is if its creditors are willing to subordinate their own claims to those of all the other creditors to the extent of the capital deficit.<sup>1285</sup> A notification of over-indebtedness cannot be withdrawn as long as a state of over-indebtedness persists;<sup>1286</sup> only a judge can determine when a company is no longer over-indebted.<sup>1287</sup> 426

## 1.1.2. Banking Companies Limited by Shares

### (1) Capital Loss

The Banking Act – and not Art. 725-725b revCO (Art. 725 CO) – is applicable to banking companies limited by shares.<sup>1288</sup> The Banking Act stipulates that FINMA may institute protective or restructuring measures – in particular, ordering the liquidation of a bank in cases of bankruptcy – not only when a bank 427

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<sup>1280</sup> Cf. CR-PETER/CAVADINI, Art. 725, par. 31.

<sup>1281</sup> Cf. LANZ, p. 38. For the consequences thereof, see also p. 38.

<sup>1282</sup> BSK II-WÜSTINER, Art. 725 par. 30.

<sup>1283</sup> Art. 716a par. 1 no. 7 CO.

<sup>1284</sup> See Art. 725 par. 2 CO.

<sup>1285</sup> See Art. 725 par. 2 CO in fine.

<sup>1286</sup> ZK-BÜRGI, Art. 725, par. 15.

<sup>1287</sup> CR-PETER/CAVADINI, Art. 725, par. 49.

<sup>1288</sup> Explicitely, Art. 25 par. 3 BankG.

is over-indebted but already when it can no longer fulfil the capital adequacy provisions after the expiry of a deadline set by FINMA.<sup>1289</sup> Banks must prove to FINMA on a quarterly basis that they have adequate capital at their disposal.<sup>1290</sup>

428 The aim of this rule is to ensure that they hold adequate capital to cover credit risks, market risks, non-counterparty risks and operational risks.<sup>1291</sup> As the Banking Act stipulates in Art. 25 par. 1, banks that are non-compliant with the capital adequacy rules for banks are treated in the same way as those that are over-indebted;<sup>1292</sup> in both cases, FINMA has a right to intervene.

## (2) *Creation of Reserves or Provisions?*

429 Reserves and provisions have the same effects: a reduction of the distributable profit.<sup>1293</sup> In the banking sector, where reserves for general banking risks are applicable, it is especially relevant to question what differentiates reserves for general banking risks from provisions. In the non-banking sector, a provision is the only instrument that indicates a potential cash outflow.<sup>1294</sup> Provisions are debts – or, more precisely, potential debts – which have a 50% likelihood of occurrence.<sup>1295</sup> Consequently, they are a kind of reserve for potential debts.<sup>1296</sup> If provisions were not debt capital but equity, they would not be considered as debt when calculating over-indebtedness, which would delay the declaration of over-indebtedness to the disadvantage of the creditors.<sup>1297</sup> However, because provisions are not equity, the requirement remains to notify the authorities if over-indebtedness is likely.<sup>1298</sup> As such, a provision and a reserve for general banking risks are both prudent and thus interchangeable in the banking sector.<sup>1299</sup> It is noteworthy that in the non-banking sector special risks re-

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<sup>1289</sup> See Art. 25 par. 1 BankG; see also Art. 26 BankG on protective measures; Art. 28 BankG et seqq BankG on restructuring; Art. 33 on liquidation of insolvent banks (bank bankruptcy).

<sup>1290</sup> Art. 14 par. 1 ERV; see the new ERV.

<sup>1291</sup> Art. 1 par. 2 ERV. See FINMA-Circ 2013/01.

<sup>1292</sup> Cf. HANDSCHIN/WIDMER, US Bankendeal, par. 18.

<sup>1293</sup> *Ibid.*, par. 9.

<sup>1294</sup> *Ibid.*, par. 9.

<sup>1295</sup> *Ibid.*, par. 10.

<sup>1296</sup> HANDSCHIN, Rechnungslegung 2013, par. 763 et seqq and 768.

<sup>1297</sup> *Ibid.*, par. 769.

<sup>1298</sup> Cf. HANDSCHIN/WIDMER, US Bankendeal, par. 10 and 19.

<sup>1299</sup> *Ibid.*, par. 19 and 22.



serves would have an impact on the moment of intervention, since the CO distinguishes between an instance of capital loss and a state of over-indebtedness (see [Paragraph 416](#)).

### (3) *Impact of Reserves on the Moment of Intervention*

In the case of a simple capital loss, a non-banking company limited by shares is not immediately obliged to issue a notification, a duty which applies only when the company is over-indebted.<sup>1300</sup> In contrast, for banking companies limited by shares, the Banking Act and its ordinances as well as the FINMA circular are applicable, all of which are much stricter and, especially in the case of the FINMA circular, require *earlier* intervention.<sup>1301</sup> 430

If reserves for general banking risks or even provisions are created, these are not relevant to the question of *capital loss* and have no impact on any calculation thereof.<sup>1302</sup> Reserves only become relevant in non-banking companies limited by shares for the calculation of *over-indebtedness*. Consequently, it is only in the non-banking sector that the creation of reserves in a company limited by shares can be used to delay a state of over-indebtedness. 431

Reserves such as reserves for general banking risks would be useful in the non-banking sector, however they are not applicable in this sector.<sup>1303</sup> Generally, reserves should be used more often to protect a company's equity and avoid over-indebtedness.<sup>1304</sup> Furthermore, I have argued in favour of the creation of special risk reserves by means of the articles of association since the creation of reserves for general banking risks is not possible in the non-banking sector.<sup>1305</sup> However, the legislators did not desire all reserves to be taken into account for the calculation of capital loss and the subsequent moment of over-indebtedness: Before the revision, the wording permitted all statutory reserves – hence, accounting reserves and legal reserves – to be taken into account for these calculations. According to the new wording, only legal reserves – hence, capital reserves and profit reserves – can be considered. Because ac- 432

<sup>1300</sup> HANDSCHIN/WIDMER, US Bankendeal, par. 19 and 22.

<sup>1301</sup> *Ibid.*, par. 17.

<sup>1302</sup> *Ibid.*, par. 19 et seqq.

<sup>1303</sup> See *Ibid.*, par. 17 et seqq.

<sup>1304</sup> See also HANDSCHIN/WIDMER, par. 19 et seqq and par. 22 in fine.

<sup>1305</sup> See delegation of the competence to create and dissolve reserves in [Paragraph 313 et seqq](#) for companies limited by shares, in [Paragraph 331](#) and [343 et seqq](#) for the limited liability companies and in [Paragraph 365](#) and [Paragraph 370](#) for the cooperatives.

counting reserves are no longer mentioned, it can be assumed that the legislation does not intend for all statutory reserves to be taken into account. Additionally, the question of whether the doctrine intends for only the non-distributable or the distributable portion thereof to be counted has also been clarified. Here, the legislative intent seems to be clear, going in the direction of taking fewer and fewer types of reserves into consideration. The CO adopted a stricter view on the use of reserves in crisis situations, which has ultimately resulted in reserves having less impact in a crisis while offering more flexibility to healthy companies. Hence, using risk reserves based on the articles of association that allow for a delegation of the competence to create and dissolve reserves to the board of directors would not have any impact on capital loss or the moment of over-indebtedness. It is precisely for this reason that risk reserves based on the articles of association are not critical for creditors, and operate as real risk reserves as long as the company is not in crisis. They are no longer to be considered from the moment at which the company enters a crisis situation, since reserves should not be used as an instrument for delaying this moment. The function of reserves is to increase risk capacity and strengthen the equity prior to this moment.

## 1.2. Limited Liability Companies

433 As per Art. 827 CO, the relevant provisions on companies limited by shares also apply to the liability of persons involved in the management, auditing or liquidation of a limited liability company. However, because of the particular structure and nature of LLCs, some specific situations require special attention.<sup>1306</sup> The definitions of capital loss and over-indebtedness that apply to LLCs are the same as for the company limited by shares. Furthermore, reserves also have the same effect in LLCs on the calculation of capital loss and over-indebtedness and consequently on the point at which intervention is required. For LLCs, as for companies limited by shares, there is no reserve that corresponds to a reserve for general banking risks; as such, a risk reserve based on the articles of association could fill this gap by providing the executive body with the option to create and dissolve reserves.

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<sup>1306</sup> Cf. HANDSCHIN/TRUNIGER, § 20, par. 9. For further information on divergences on exception of liability limitation, as per. Art. 754, see HANDSCHIN/TRUNIGER, § 10, par. 29 et seqq.

The fact that there are no LLC bank companies and that a comparison between the two sectors is not possible does not affect the applicability of these conclusions to LLCs. This means that reserves have the same effects on LLCs as those described above for companies limited by shares. 434

### 1.3. Cooperatives

The former Art. 903 CO (in force until 31 December 2022) on the duty to report cases of capital loss or over-indebtedness also distinguishes between capital loss and over-indebtedness.<sup>1307</sup> Although the ratio legis is the same as in company limited by shares law and limited liability law, Art. 903 CO does not refer to these regulations due to a legislative error.<sup>1308</sup> The revised Art. 903 revCO (Art. 903 CO) – finally – refers to the regulations for companies limited by shares in Art. 725-725b revCO (Art. 725 CO) in relation to the duty to notify the relevant authorities in a case of capital loss or over-indebtedness. They must thus submit an interim balance sheet to a licensed auditor for examination.<sup>1309</sup> Based on this new referral, reserves have the same effect in cooperatives as in companies limited by shares and LLCs. 435

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<sup>1307</sup> A nominal capital by means of cooperative shares exists. See Art. 833 no. 1 CO; BSK II-WÜSTINER, Art. 903, par. 2.

<sup>1308</sup> Botschaft 2007, p. 139.

<sup>1309</sup> CHK-MÜLLER/FORNITO, Art. 903, par. 4.



## 2. Reserves based on the Articles of Association and the New Capital Band

This chapter will compare reserves based on the articles of association, which I argue may be created by the general assembly as well as by the board of directors by means of the articles of association, to the CO's newly introduced capital band and to the additional capital instruments in the Banking Act.<sup>1310</sup> 436

### 2.1. Capital Band in the CO

#### 2.1.1. Definition

The new Art. 653s revCO et seqq offer the opportunity to adopt articles of association that empower the board of directors with the authority to increase and decrease the capital within a certain range by means of the articles of association. This new instrument,<sup>1311</sup> which has replaced the old authorised capital increase in Art. 651 et seqq CO,<sup>1312</sup> gives the board of directors much more flexibility to increase and decrease the share capital.<sup>1313</sup> Previously, the authorisation of a capital increase was an inalienable competence of the general assembly.<sup>1314</sup> With the introduction of the new article in the CO, the board of directors now enjoys the authority – based on the articles of association – to amend the capital, including through reduction, until the expiration of the corresponding article in the articles of association after a set period of time not exceeding 5 years.<sup>1315</sup> Thus, the mechanism is similar to the already known capital increase according to the actual Art. 651 CO (in force until 31 December 2022) in which the general meeting could authorise the board of directors to increase the share capital for an maximum period of two years. Decisions on equity, meanwhile, remain in the competence of the general assembly. 437

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<sup>1310</sup> See Art. 11-13 BankG.

<sup>1311</sup> Cf. See Botschaft 2016, p. 513 with further references: VON DER CRONE, Bericht, Teil 1, pp 19 et seqq.

<sup>1312</sup> Botschaft 2016, p. 513. For further details, see: SCHENKER, FS Vogt, p. 180.

<sup>1313</sup> Botschaft, p. 513.

<sup>1314</sup> Ibid.

<sup>1315</sup> Art. 653t par. 2 revCO.

### 2.1.2. Creditors' Protection

438 In the context of changes to the share capital, the issue of creditors' protection becomes relevant, in support of which the new article has been added.<sup>1316</sup> The concept of a capital band contained therein accepts the need to protect creditors before any resolution by the general assembly to establish a capital band can be passed.<sup>1317</sup> The capital band's lower limit must not fall below the value of one-half of the share capital, as it has been entered into the commercial register.<sup>1318</sup> Moreover, in order to protect the shareholders and their interests, their consent or collaboration is required for the inclusion of a capital band in the articles of association.

### 2.1.3. Comparison to Reserves

439 There are some similarities between this form of capital band and the instrument proposed in this work, including the option to delegate the general assembly's competence to form and dissolve reserves – as both grant the board of directors great flexibility to react more quickly through its empowerment by the general assembly.<sup>1319</sup> However, as I have similarly argued for reserves based on the articles of association, a capital band still requires collaboration between the board of directors and the general assembly, which provides a choice between delegating its competence to form and release reserves to the board of directors and making use of hidden reserves or other potential risk protection instruments as the reserves based on the articles of association. The CO has stricter rules for the option of a capital band in the articles of association than for reserves based on the articles of association.<sup>1320</sup> Similarly strict rules would also be favourable for regulating delegations of the competence to form and dissolve reserves based on the articles of association.

## 2.2. Additional Capital in Banks

440 The Banking Act already includes two concepts for empowering the executive body with the authority to make changes to the share capital that are similar to that of the capital band; however, as these are only similar and not identical

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<sup>1316</sup> Botschaft 2016, p. 516.

<sup>1317</sup> Ibid.

<sup>1318</sup> Art. 653s par. 2 in fine revCO. For the upper limit, see Art. 653s par. 1 and 2 revCO.

<sup>1319</sup> In the concept of capital band, the winner is also the board of directors, See SCHENKER, FS Vogt, p. 191.

<sup>1320</sup> See Art. 653t par. 1 no. 1-10 revCO.

to a capital band, the latter also applies to banks.<sup>1321</sup> When these concepts come into conflict with each other, the *lex-specialis*-rule is used to decide which takes precedence.<sup>1322</sup> The two concepts in the Banking Act are only applicable when a company is permitted to issue share capital or participation capital.<sup>1323</sup> As such, these additional capital instruments are also available to cooperatives. The aim of the introduction of additional capital is to strengthen a bank's capital in order to prevent future crises,<sup>1324</sup> such as insolvency or bankruptcy.<sup>1325</sup>

There are two types of additional capital: buffer capital and conversion capital. Buffer capital may be created when the general assembly chooses to allow or empowers the board to make changes in the share capital or the participation capital by amending the articles of association,<sup>1326</sup> a rule which is based on the former authorised capital increase regulation contained in Art. 651 et seqq CO (in force until 31 December 2022).<sup>1327</sup> As such, the term “buffer” is not sufficiently precise<sup>1328</sup> and could be misleading at first glance. At the time when this concept was introduced, the “extended delegation competence” could be invoked within a limited and predefined scope.<sup>1329</sup> In contrast to buffer capital, but only when a triggering event occurs, debt securities arising from mandatory convertible bonds are converted into shares or participation certificates, resulting in a contingent increase in capital known as conversion capital.<sup>1330</sup> Opinions on the origins diverge,<sup>1331</sup> but these two concepts (i.e. buffer capital and participation capital) do show how competences also overlap in banks and how far a delegation of a competence may likewise go in banks. Furthermore, while these concepts also demonstrate that similar concepts from the non-banking sector tend to be modified slightly in the banking sector, it is likewise clear that the banking and non-banking sectors continuously influence each other.

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<sup>1321</sup> Schlussbericht TBTF, pp 93 et seqq.

<sup>1322</sup> Botschaft, p. 514.

<sup>1323</sup> BSK BankG-REUTTER/RAUN, Art. 11 par. 22.

<sup>1324</sup> See Art. 11 par. 3 BankG; Botschaft TBTF, pp 4726 et seq.

<sup>1325</sup> Cf. Schlussbericht TBTF, p. 85.

<sup>1326</sup> See Art. 12 par. 1 BankG.

<sup>1327</sup> Botschaft TBTF, p. 4768.

<sup>1328</sup> BSK BankG-REUTTER/RAUN, Art. 12 par. 1.

<sup>1329</sup> Schlussbericht TBTF, p. 85.

<sup>1330</sup> Art. 13 par. 1 BankG.

<sup>1331</sup> This is a new legal concept, Botschaft TBTF, p. 4768; on special types of contingent capital increase; see BÖSCH/LEISINGER, SWZ 2012, 12.





### 3. Delegation of the Competence to Revoke the Subscription Right

This chapter will compare the proposed delegation of competences with a very similar concept upheld by the Federal Supreme Court in its BGE 121 III 219 judgment, which recently has been codified (with further development) in Art. 653t Abs. 1 no. 7 revOR. The court decided that the competence to restrict or revoke the shareholders' subscription right, as per Art. 652b CO (but see the revised Art. 652b revCO), may be delegated by means of the articles of association to the board of directors. According to the right of subscription, every shareholder is entitled to a proportion of any newly issued shares that corresponds to their existing participation.<sup>1332</sup> The same questions arise in relation to the delegation of this competence as in relation to the delegation of the competence to create and dissolve reserves. 442

#### 3.1. Delegability of Competences

The Federal Supreme Court decided in its judgment that the wording of Art. 651 par. 3 CO<sup>1333</sup> indeed does not permit a delegation of the competence; however, although the wording and the grammatical interpretation thereof do not correspond to the ratio legis of the regulation, there is a loophole that allows for a delegation.<sup>1334</sup> It is unclear where the line is to be drawn between a loophole that may be closed by a judge *contra verba aber secundum rationem legis* and a false loophole, the closure of which would constitute a fundamentally invalid judicial ruling.<sup>1335</sup> 443

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<sup>1332</sup> Art. 652b par. 1 CO.

<sup>1333</sup> See also Art. 650 par. 2 no. 8 CO; Art. 651 par. 3 CO; Art. 698 par. 2 no. 6 and Art. 704 par. 1 no. 6 CO.

<sup>1334</sup> Cf. Consideration 1.d/cc. According to the jurisprudence of the Federal Supreme Court, a genuine legal loophole exists when a regulation is omitted, thus allowing no rules or provisions to be read from (1) the wording of the law or (2) by interpretation thereof. BGE 108 Ib 78 consideration 4b p. 82. Only this type of loophole may be closed by a judge. Cf. BK-MEIER-HAYOZ, Art. 1 CC, par. 295 et seqq. A false legal loophole occurs when the assumption of the facts and issues, as demanded by the clear wording of the article, appears incompatible with the *telos* of the law in its application. Cf. BK-MEIER-HAYOZ, Art. 1 CC, par. 271 et seqq.

<sup>1335</sup> Consideration 1.d/aa.

- 444 The wording contradicts its ratio legis, namely to permit a company to make use of a flexible instrument in special circumstances in order to obtain more capital. Art. 651 par. 3<sup>1336</sup> and Art. 652b CO would not permit the board of directors to decide on the shareholders' subscription right; however, Art. 652b CO, in particular, contradicts the ratio legis of 651 par. 3 CO, as a result of which its content will be modified, and the contradictory aspects of the norm or norms will be reduced to a minimum. This will allow capital to be procured in a flexible manner according to each company's capital needs.<sup>1337</sup> As such, the shareholders' subscription right, as per Art. 652b CO, may be interpreted by teleological reduction, thus permitting a delegation.<sup>1338</sup> The Commercial Court, however, decided that there is a mandatory distribution of competences in favour of the general assembly based on Art. 651 par. 3 in conjunction with Art. 650 par. 2 no. 8 and Art. 698 par. 2 no. 6 CO.<sup>1339</sup>
- 445 The impact of the delegation of competences proposed in this work is less problematic than the delegation upheld in the judgment. Not only does the wording allow for a delegation, but the board already has the competence to create hidden reserves and accounting reserves. Furthermore, in the banking sector, the executive body is allowed to create reserves for general banking risks without possessing a delegation power anchored in a Federal Act. Finally, given the shareholders' right to a dividend, as per Art. 660 par. 1 CO, and the requirement for the use of additional reserves to be in the interests of all shareholders, as per Art. 674 par. 2 no. 2 CO, such a dispute over the delegation of the competence to create and dissolve reserves could potentially also end up in court. However, if the articles of association comply with Art. 674 par. 2 no. 2 CO (Art. 673 par. 2), there is no justification for a court challenge and little probability of winning such a case. The revised law requires all further reserves to be viewed in light of the long-term prosperity of the company, and the best interests of the shareholders.<sup>1340</sup> Art. 674 par. 2 no. 2 CO will be moved to Art. 673 par. 2 revCO, where the "or" will be replaced by an "in", thus, both requirements will be mandatory. A stable dividend will no longer be a reason to

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<sup>1336</sup> With the introduction of the new capital band, Art. 651 will no longer be needed, and therefore deleted. See Botschaft 2016, p. 498.

<sup>1337</sup> Cf. Consideration 1a/cc.

<sup>1338</sup> Cf. Consideration 1a/cc and Consideration 5.

<sup>1339</sup> Consideration 1 and 1.d.

<sup>1340</sup> Art. 673 par. 2 revCO.

create reserves in the revised CO.<sup>1341</sup> Thus, the creation of further reserves will be allowed only in favour of the company and in considering the shareholders' interest.<sup>1342</sup>

### 3.2. Delegation requirements

Based on the teleological reduction (of the shareholders' subscription right Art. 652b CO) according to which the contradictory norms (or contradictory sections thereof) must be used in accordance with their telos – in this case, the flexibility of capital procurement, as per Art. 651 par. 3 CO – the Federal Supreme Court has added a further requirement: a decision by the general assembly to empower the board of directors with this competence must be accompanied by a very clear description of the essential purpose for which the shareholders' subscription right is to be revoked.<sup>1343</sup> Additionally, in Art. 652b par. 2 CO, it is further stipulated that a resolution by the general assembly to increase the share capital may only revoke this subscription right with good cause: in particular, the takeover of companies or subsidiaries thereof, equity interests, and employee share ownership are all deemed to qualify as good cause. According to Consideration 2, it would be insufficient to base this only on one such reason. A legitimate reason or purpose must be provided for empowering the board of directors with the authority to decide on its own to revoke the shareholders' subscription right. Finally, based on the confidence principle in corporate law, the board of directors is obligated to disclose its specific intentions<sup>1344</sup> and ensure a balance between its own interests and those of the shareholders.<sup>1345</sup>

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As with the delegation of the competence to form or release reserves, the purpose of a delegation of the competence to revoke the shareholders' subscription right must be defined clearly. However, in contrast to the former, the general assembly is free to impose restrictions, permit a delegation for only a limited period of time or a specific project, or authorise a full delegation. Thus, in the case of the delegation competence promoted in this work, the general assembly enjoys more freedom to stipulate the conditions of delegation. A bal-

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<sup>1341</sup> Art. 674 par. 2 CO will be deleted.

<sup>1342</sup> See Art. 673 par. 2 revCO and Art. 674 par. 2 no. 2 CO.

<sup>1343</sup> Consideration 2 and 5.

<sup>1344</sup> Consideration 2.

<sup>1345</sup> Consideration 3.

ance of interests thus occurs between the shareholders' right to a distribution of profit and the flexibility needed by the board to form reserves. In so doing, the general assembly temporarily gives up its authority to form reserves.

### 3.3. Shareholders' Rights

- 448 The balancing of the interests of the individual shareholders with those of the board – especially from the point of view of the individual shareholder – is not identical in large listed public companies to that in SMEs.<sup>1346</sup> In a large and listed company, an individual shareholder's subscription right is less likely to be violated than in the case of a shareholder of a small company, because shareholders of large and listed companies can maintain the proportion of their existing participation. The Federal Supreme Court explicitly stated that it would have reached a different decision in relation to SMEs, for which it would allow the restriction or withdrawal of the shareholders' subscription right only for purposes of a clearly defined project.<sup>1347</sup>

### 3.4. Legal Remedies

- 449 The judgment stipulates the same legal remedies if a delegation of the competence to create and dissolve reserves is anchored in articles of association that contravene the law. In such a case, Art. 706 CO states that the resolution may be challenged. Moreover, the shareholders have two further instruments that allow them to challenge an abuse of a delegated competence by the board of directors: directors' liability<sup>1348</sup> as well as business management and administration liability.<sup>1349</sup>

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<sup>1346</sup> Consideration 2.

<sup>1347</sup> Ibid.

<sup>1348</sup> See Art. 722 CO.

<sup>1349</sup> See Art. 754 CO.

## Preliminary Conclusion to Part III

Part III focused on the general impact of reserves, especially in relation to capital protection and the point at which the authorities may intervene. The moment at which the authorities can intervene differs in the non-banking sector from the banking sector, with intervention in the latter already possible at an earlier point. 450

When calculating a capital loss in the non-banking sector, only statutory reserves are taken into consideration. As other categories of reserves, like reserves based on the articles of association, are not considered in the calculation of a capital loss, this brings forward the moment of capital loss rather than delaying it. When calculating over-indebtedness due to the presence or absence of reserves, two terms and definitions are used: real over-indebtedness is defined as the absence of equity after the dissolution of open and hidden reserves; false over-indebtedness occurs when no equity is recorded on the books but there may be additional equity in the form of some hidden reserves. 451

In the banking sector, the point at which an intervention can occur is determined exclusively by the calculation of capital loss. Hence, the authorities can intervene much earlier than in the non-banking sector. Consequently, in the banking-sector, the impact of reserves should be compared with the impact of provisions at the moment of capital loss. In the non-banking sector, a provision is the only instrument that indicates a potential cash outflow. Provisions are debts – or, more precisely, potential debts – that have at least a 50% likelihood of occurrence; as such, they act as a kind of reserve for potential debts. If provisions were classified as equity rather than as debt capital, they would not be considered as debt when calculating over-indebtedness, thus postponing the moment of over-indebtedness to the disadvantage of the creditors. However, the fact that provisions are not equity does not have an impact on the moment at which the authorities must be notified, since over-indebtedness would be similarly threatened in both situations. As a result, a provision and a reserve for general banking risks are both prudent and interchangeable in the banking sector. However, it is precisely in the non-banking sector – in which special risk reserves would have an important impact due to the differentiation between a single capital loss and a state of over-indebtedness – where they are currently not permitted. 452

- 453 In the banking sector, FINMA can intervene – especially in order to ensure capital protection – as soon as equity capital regulations are not observed or serious liquidity problems arise as per Art. 25 Banking Act. In contrast, reserves only become relevant according to HANDSCHIN and WIDMER in non-banking companies limited by shares when calculating over-indebtedness, since a state of over-indebtedness is the only legitimate justification for an intervention by the authorities in the non-banking sector. The creation of a reserve for general banking risks would only have an impact on the calculation of over-indebtedness – which it may delay – in companies limited by shares in the non-banking sector. This means that reserves, such as reserves for general banking risks, are not permitted in the non-banking sector, even though they would have a significant impact there. Solutions to this contradiction should be considered, such as my proposal to empower the board with the authority to form and disclose risk reserves based on the articles of association for a specific period of time, as is permitted in the banking sector. However, following GLANZMANN, I argue that risk reserves based on the articles of association are not to be taken into account. It is precisely for this reason that they have no impact on the calculation of over-indebtedness and do not delay the point at which the authorities can intervene. The function of reserves is to increase risk capacity and significantly strengthen the equity prior to this moment. Hence, the excessive use or even abuse of reserves based on the articles of association by the board of directors is not possible, and thus does not represent a danger for the shareholders or the creditors.
- 454 Finally, it has been shown that such a delegation or transfer of competences is possible by invoking other concepts of law that relate to the specific issue of equity and capital protection.
- 455 Furthermore, it brings huge advantages with it for the executive body, even though at first glance it would appear to interfere with the shareholders' rights. However, under closer scrutiny, the rights of the shareholders are not contravened for the following reasons. First, the shareholders must approve any amendment to the articles of associations. Second, the shareholders may choose the precise wording of an amendment to the articles of association that includes a transfer of the competence to create and dissolve reserves to the board of directors. For example, the shareholders can restrict the applicability of reserves to a specific circumstance, risk or limited period of time by stipulating this in the articles of association.

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The comparison with the Federal Supreme Court's judgment BGE 121 III 219 allowed for an analysis of the question of the distribution of competences, the transfer of the competence and the requirements for a delegation of this competence. Moreover, potential remedies for a decision by the general assembly to amend the articles of association in favour of a delegation or potential remedies for an abuse of this delegation by the board of directors were also examined. In relation to both of these potential situations, clear wording in the articles of association is important. However, since the competence to form and release reserves can be delegated more freely for an unlimited period of time without needing to serve a specific purpose, a better analogy for the creation and dissolution of this type of reserve would be reserves for general banking risks. Smaller companies, including family companies, usually have wider delegation powers because individual shareholders may see the situation more clearly and are more likely to decide to grant the board of directors wider and more manageable competences. In a large publicly listed company, by contrast, shareholders would tend to regard this as violating their right to a dividend, a perspective which must be taken into consideration when defining clear limitations for a delegation.





## Critical Reflections and Main Conclusions

Part I provided an overview of the notion of reserves as well as the ways in which they protect equity through increasing the distribution limit.<sup>1350</sup> The differences between various types of hidden reserves and similar, non-equity instruments, such as mandatory and voluntary provisions, were shown as well as the different ways in which these are formed or emerge, including through the board of directors' – or, more generally, the executive body's – competence to create various types of hidden reserves.<sup>1351</sup> In this context, Art. 959c par. 1 no. 3 CO was criticised for not prohibiting offsetting and only requiring the disclosure of the balance between the dissolved reserves and the newly created arbitrary hidden reserves. However, there is a rule for arbitrary hidden reserves that requires de lege lata mandatory disclosure. This rule could be expanded de lege ferenda. Currently, in fact, companies are already free to disclose additional information. Ultimately, however, the use of reserves based on the articles of association is preferred in this work.<sup>1352</sup>

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Additionally, all types of open reserves were described. In summary, there are four categories of open reserves: 1) accounting reserves, including revaluation reserves and fluctuation reserves as well as negative reserves, which are all created and released by the executive body as part of its competence for organising the accounting; 2) legal reserves, including capital reserves and statutory retained earnings reserves, the creation and release which fall under the competence of the general assembly; 3) voluntary retained earnings reserves, which are based either on the articles of association or on a resolution by the general assembly;<sup>1353</sup> and 4) reserves for general banking risks, a special category of reserves that is only applicable in banks. These reserves have an insufficient legal basis, as they contain a competence delegation from the general assembly to the board of directors. In particular, this work favours reserves based on the articles of association, which have outstanding potential in the non-banking sector – in which there is currently no available option for creating risk reserves – as an equivalent to reserves for general banking risks, which are currently only available to banks.<sup>1354</sup>

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<sup>1350</sup> Cf. [Paragraph 10 et seqq.](#)

<sup>1351</sup> Cf. [Paragraph 28 et seqq](#) and [32 et seqq.](#)

<sup>1352</sup> Cf. [Paragraph 57 et seqq.](#)

<sup>1353</sup> Cf. [Overview in Paragraph 154](#) of the open reserves in the CO.

<sup>1354</sup> Cf. [Paragraph 153 et seqq.](#), [Paragraph 155 et seqq.](#)

- 459 The systematic position of revaluation reserves in the CO was found to be inappropriate. As this type of reserve is an accounting reserve, its position before the other legal reserves, all of which can only be created and dissolved by the general assembly, was incorrect (Art. 670 OR; Art. 725c revCO). By maintaining this reserve in the CO, the legislator has made a move towards a more modern approach of real or fair value like in the IFRS and the acceptance of open reserves – and, as such, towards greater prudence and transparency.<sup>1355</sup> Furthermore, the real function of negative reserves was questioned. It was concluded that a negative reserve does not function as a reserve, and thus reporting it as a negative item could *de lege ferenda* simply be omitted, since a negative reserve merely acts as a compensation instrument on the balance sheet.<sup>1356</sup>
- 460 In summary, I have found through my examination of compliance with the principles of financial accounting that open reserves are both prudent and transparent.<sup>1357</sup> Furthermore, my analysis of banking regulations shows that there is no reason why a special reserve could not be permitted in the non-banking sector that could also provide a protective function for shareholders and creditors.<sup>1358</sup>
- 461 Part II was concerned with the question of which organ has the competence to create and release reserves in companies limited by shares, limited liability companies and cooperatives. This required a deeper analysis of the allocation of competences in each type of company in order to assess the extent to which delegation is admissible and appropriate. My findings have shown that, even though the parity principle must be applied strictly in companies limited by shares, there are a series of checks and balances between the general assembly and the board of directors. The competence to create and dissolve reserves involves an interplay between both organs due to the interrelatedness of the profit distribution and financial reporting processes, which are classified as “approval competences”, and the CO’s clearly defined option permitting the delegation of competences from the general assembly to the board of directors. Ultimately, shareholders do not lose their power in the delegation process, because they retain the authority to approve or reject any decisions. As such, the general assembly may make a provision in the articles of association for a delegation of competences based on the articles of association. The

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<sup>1355</sup> Cf. [Paragraph 68 et seqq.](#)

<sup>1356</sup> Cf. [Paragraph 97 et seqq.](#)

<sup>1357</sup> Cf. [Paragraph 190 et seqq.](#)

<sup>1358</sup> Cf. [Paragraph 213 et seqq.](#)

new Art. 673 revCO (Art. 672 CO) has not introduced any changes in this regard. The relevant articles of association can be formulated in a very open-ended manner that gives significant discretion to the board, but they can also restrict delegations to a specific time period, value, potential risk or potentially risky circumstance.<sup>1359</sup> Ultimately, since the board is responsible for the overall supervision of management as opposed to the execution of management tasks and the day-to-day management, a further delegation of the competence to create and release reserves is not only admissible but preferred due to the superior technical knowledge of specialist managers.<sup>1360</sup>

At first glance, these conclusions cannot simply be applied in an identical manner to limited liability companies – a model in which managing members must be independent from non-managing members – because the parity principle is relativised as a result of the person-based nature of this form of company. The allocation of competences in limited liability companies is much more flexible than in companies limited by shares, but the checks and balances between the members' meeting and the executive body apply in equal measure.<sup>1361</sup> Finally, the above-described delegation norm and the corresponding nature of the competence to create and release reserves may be applied by analogy to limited liability companies.<sup>1362</sup>

Finally, in a cooperative, a delegation to the executive body – the administration – of the general assembly's competence to create and release reserves is also admissible, as per Art. 863 par. 1 CO, but only as an exception to the general principle of democratic decision-making that applies in cooperatives.<sup>1363</sup> A further delegation to a manager is possible; however, the rules on the inclusion of members are much stricter, because these would need to be anchored in the articles of association and would thus be subject to a very democratic approval process.<sup>1364</sup>

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<sup>1359</sup> Cf. [Paragraph 295 et seqq.](#)

<sup>1360</sup> Cf. [Paragraph 310 et seqq.](#)

<sup>1361</sup> Cf. [Paragraph 316 et seqq.](#)

<sup>1362</sup> Cf. [Paragraph 343 et seqq.](#)

<sup>1363</sup> Cf. [Paragraph 365.](#)

<sup>1364</sup> Cf. [Paragraph 369 et seqq.](#)

- 464 A comparison between the banking and non-banking sectors illustrates that a delegation of business management is not permitted in the banking sector, but this does not explain the existence of the option available to banks to create additional reserves. Instead, it would be expected that the contrary should apply given that the corporate governance rules are stricter for banks.<sup>1365</sup>
- 465 Part III examined the effects of open reserves in non-banking companies limited by shares and reserves for general banking risks in banking companies limited by shares. Although reserves for general banking risks do not have the impact that would be expected of them in the banking sector, their inadmissibility in the real economy is significant according to HANDSCHIN and WIDMER, since they would play a crucial role in the non-banking sector by delaying the point at which a company becomes over-indebted. I argue, however, that they do not have such an impact and therefore could be used without the risk that they would delay this critical moment.<sup>1366</sup>
- 466 Furthermore, a comparison between the delegation of the competence to create and release reserves based on the articles of association, as per Art. 673 CO (Art. 673 revCO), and a similar concept, the newly introduced capital band, shows how the latter makes use of an “extended delegation competence”. This entails the empowerment of the board of directors, to which the general assembly can transfer a competence for purposes of flexibility and risk protection. The result thereof is similar to the effects of open and transparent risk reserves based on the articles of association.<sup>1367</sup>
- 467 Finally, the proposed delegation of the competence to create and dissolve reserves is compared to a judgment by the Federal Supreme Court (BGE 121 III 219) on a dispute over a delegation of competences based on the articles of association. By analysing this decision and its position on the distribution of competences, the impact of the size of a company, and the effects of the requirement for clear description and delimitation of the delegation in the articles of association, it can be concluded that a delegation of the competence to create and dissolve reserves would be permitted by the Federal Supreme Court.<sup>1368</sup>

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<sup>1365</sup> Cf. [Paragraph 371 et seqq.](#)

<sup>1366</sup> Cf. [Paragraph 416 et seqq.](#)

<sup>1367</sup> Cf. [Paragraph 436 et seqq.](#)

<sup>1368</sup> Cf. [Paragraph 436 et seqq.](#)





## **Curriculum Vitae**

Yvette Maerki was born in 1985 in Basel, where she obtained her Matura in 2004 at the Gymnasium am Münsterplatz. After studying Medicine at the University of Geneva, she began law school at the University of Basel. In 2015 she received her bachelor's degree in law, and a year later completed her master's degree with a focus in corporate law and general law. During her law studies she participated in the European Court of Human Rights' Moot Court, and went on to coach the winning team (Prof. Dr. Stephan Breitenmoser, Chair of European and Public International Law). In 2016 she began her doctoral studies. While the revision of the Code of Obligations (Aktienrechtsrevision) was underway, she completed internships with the Basel-Landschaft Tax Administration, the Basel-Landschaft Tax Court, the Basel-Stadt Civil Court, and in a law firm. From November 2020 to May 2022 she was a judicial clerk in the Federal Administrative Court. Currently she is a judge in the Basel-Stadt Criminal Court.

This work examines reserves in the recently revised Swiss Code of Obligations, which will enter into force 1 January 2023. The analysis focuses on their creation and dissolution, and distinguishes between reserves formed by the board and reserves formed by the general assembly. By focusing on an instrument in the banking sector, the reserves for general banking risks, this work investigates the general assembly's possibility to delegate the power to form further reserves to the board of directors based on the articles of the association. This question is analyzed in the context of companies limited by shares, limited liability companies, and cooperatives. Finally, the effects of such a delegation and the consequences in a practical view of going to court are analyzed through the Federal Supreme Court's judgment in a similar topic of delegation.