

Switzerland

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Introduction

By various indicia, the Swiss economy is among the most international.¹ Switzerland is home to fifteen of the world's global companies,² and even its small and middle-size enterprises display high levels of crossborder activity.³

The extent of the country's internationalization is reflected not only in the crossborder orientation of its companies but in its high degree of openness to foreign talent. For example, in 2014, forty-two per cent of board chairs and forty-seven per cent of CEOs of Swiss public companies were non-Swiss or dual nationals.⁴

1 The title of this work is "Organizing and Managing Compliance: The Swiss Perspective". The author thanks those who provided input for this article and Patrick Zumsteg for his valuable research support. Despite a population of less than 8.4-million inhabitants, Switzerland is the 14th largest exporting country in the world. World Atlas, "The World's 20 Largest Exporting Countries", 2017, see <https://www.worldatlas.com/articles/exports-by-country-20-largest-exporting-countries.html>; World Trade Organization, "World Trade Statistical Review", 2017, see https://www.wto.org/english/res_e/statistics/wts2017_e/wts17_toc_e.htm.

2 Geolounge, "Geography of Global 500 Companies in 2016", 2016, see <https://www.geolounge.com/geography-global-500-companies-2016/>.

3 According to a Credit Suisse 2014 Study, 69 per cent of all Swiss SMEs engage in direct or indirect crossborder commercial activity. Credit Suisse, "Erfolgsfaktoren für Schweizer KMUs", June 2014, at p. 5, see <http://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=FF9EDB95-BF2E-C0FD-4335D784B62787D5>. Another study finds that up to 79 per cent of SMEs ultimately pursue international strategies, with 9.4 per cent actually being "born globals", i.e., companies who aim toward multinationalism from their start-up. Freiburg School of Management, "Swiss International Entrepreneurship Survey 2016", at p. 12, see http://www.heg-fr.ch/FR/HEG-FR/Communication-et-evenements/evenements/Documents/Swiss_International_Entrepreneurship_Survey_2016_EN.pdf.

4 HCM International Swiss 100 Study, 2014. At 49 per cent, the proportion of non-Swiss or those having Swiss and another nationality was even higher in Executive boards.

Additionally, in the twenty companies that make up the major Swiss index of public-listed companies, there are currently at least eight heads of a legal or control function⁵ who are foreign or dual nationals.⁶ Furthermore, even the head of Switzerland's banking, securities, and insurance regulator was until recently a foreigner.⁷ That such a sensitive position could be occupied by a non-national would be in many countries inconceivable.⁸

Against this backdrop, it is not surprising that how Swiss companies think about and organize compliance today, and the way regulators approach the subject, is colored to a significant degree by international trends. One source of influence are the practices of leading global companies⁹ that sometimes are early movers in experimenting with new compliance approaches.

However, another source is the standards of international organizations¹⁰ and of legal and regulatory authorities in influential

⁵ "Control functions" are increasingly understood in the market to refer primarily to Risk Management, Internal Audit, and Compliance.

⁶ Statistics from the Swiss Market Index (SMI), derived by HCM International, 2018.

⁷ Mark Branson, Director of FINMA. In 2017, he obtained Swiss citizenship. Bilanz, "Mark Branson ist endlich Schweizer", November 2017, see <https://www.bilanz.ch/people/einburgerung-mark-branson-ist-endlich-schweizer>.

⁸ The external orientation of Switzerland begins already in its educational institutions. English is offered already in primary school and an increasing number of high schools and universities now offer bilingual options. Two Swiss universities occupy the number one and two positions in the world in a recent survey of the most international higher education establishments. Times Higher Education Rankings, "Most international universities in the world 2018: top 200", March 2018, see <https://www.timeshighereducation.com/student/best-universities/most-international-universities-world-2018>.

⁹ For example, in the first report by the Swiss financial services regulator, FINMA, regarding the progress by Swiss insurers on governance, compliance, and related areas, reference is made that the "submissions reveal examples of good practices, some matching up with what leading companies internationally are pursuing". See FINMA *Mitteilung* May 2010 at <https://www.finma.ch/en/search/>.

¹⁰ This includes the so-called international standard setters. The term "standard setters" is used in this article to refer to organizations that issue international guidance or standards in respect of any industry. In the financial services area, this includes the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), and the International Association of Securities Commissions (IOSCO). For an overview of the evolution of compliance standards from an international perspective, see Varges, "Emerging International Indicators for Compliance Function Expectations", Lexis-Nexis 2010, see <https://www.lexisnexis.com/LegalNewsRoom/top-emerging-trends/b/emerging-trends-law-blog/posts/emerging-international-indicators-for-compliance-function-expectations>.

jurisdictions, such as the EU, the United Kingdom, and the United States. The influence¹¹ affects five main areas:

- (1) The role of the board of directors in compliance oversight;
- (2) The notion of a compliance function;
- (3) The independence, authority, and resources of the compliance function;
- (4) The scope of the compliance function; and
- (5) The connection of compensation to compliance.

Role of Board of Directors in Compliance Oversight

Code of Obligations Context

Comparable to jurisdictions of similar legal heritage, members of the board of directors (the “board”) of Swiss companies are bound by two bedrock principles:¹² the duty of loyalty and the duty of care.¹³ The duty of care is of particular value from a high-level compliance perspective. It implies an inherent obligation by board members to exercise care not only to avoid being personally non-compliant, but to see that the company does not breach its obligations.

The duty of care in the above context is helpful conceptually. However, despite some stretching by commentators, it has been of limited value for driving an understanding of the practical measures that a board must ensure are in place to promote compliance at the company.

For example, this duty has not been the principal basis for recognizing the role of specific preventive compliance techniques, such as a code of conduct or rigorous mechanisms to identify and address

11 The described influence also affects Swiss substantive law and regulation, such as in the area of money laundering and corruption. This article, however, is limited only to the impact on how companies execute on compliance.

12 This article focuses on relevant duties set out in the Code of Obligations (CO). This article does not cover other aspects of commercial or company law. For an overview in English of these areas, see Lengauer et al., “Company Law in Switzerland”, 2009; Kunz, “Swiss Corporate Governance”, 2010. Various efforts on modernizing Swiss company law are now in motion, including with regard to gender representation and executive pay. With respect to executive pay, see Varges, “Governing Remuneration”, in Emmenegger (ed.), *Corporate Governance* (2011), see <http://www.hcm.com/de/aktuelles-publikationen/hcm-studien-und-viewpoints/>.

13 Code of Obligations, Article 717, Paragraph 1.

potential conflicts of interest. This has remained so despite two other key principles in Swiss law:

- (1) The board is obliged to ensure that the company has appropriate *Anweisungen*, which in the largest sense can be interpreted to mean policies and directives;¹⁴ and
- (2) The board is obliged to supervise those “entrusted with managing the company”, including those who manage as regards “complying with the law ... and internal policies”.¹⁵

Criminal Law and other Contexts

More tangible reference points on the board’s (and management’s) duty on compliance have come from certain developments in Swiss criminal and administrative law. In some ways paralleling those in other jurisdictions,¹⁶ these developments have tended to expand liability of the company collectively or of its leaders individually for certain acts or events.

For example, with regard to certain laws dealing with the environment and weapons, Swiss courts have found liability even for negligence in not taking sufficient steps to prevent others from violating the law.¹⁷

¹⁴ Code of Obligations, Article 716a, Paragraph 1. More fruitful for compliance — though also within limits — has been another article of the Code of Obligations, Article 728, Paragraph 1, Line 3. This requires the company’s auditors to certify the existence of an “internal control system”. The debate on what constitutes an internal control system is still ongoing but increasingly it is understood as including compliance controls and potentially a compliance function.

¹⁵ Code of Obligations, Article 716a, Paragraph 1(5), although a common interpretation here is that the reference is to supervising management, not supervising a compliance function directly.

¹⁶ Various European countries have introduced corporate liability provisions, usually predicated also on the company’s failure to have in place appropriate systems and controls. For an overview in Europe, see Clifford Chance, “Corporate Liability in Europe”, January 2012, at https://www.cliffordchance.com/content/dam/cliffordchance/PDF/European_Technical_Bulletin.pdf. For a critical view of these developments, see Menis, *The Fiction of the Criminalisation of Corporate Killing*, *Journal of Criminal Law*, 11 October 2017, see <https://doi.org/10.1177/0022018317734707>. A seminal case on the subject in the United States is the 1996 Delaware case known as *Caremark*. See [https://advance.lexis.com/api/document/collection/cases/id/3RR5-FWC0-003C-K012-00000-00?cite=698percent 20A.2d per cent20959&context=1000516&origination=casebriefs](https://advance.lexis.com/api/document/collection/cases/id/3RR5-FWC0-003C-K012-00000-00?cite=698percent%20A.2d%20per%20cent20959&context=1000516&origination=casebriefs).

¹⁷ See the ruling by the Swiss Supreme Court (*Bundesgericht*), BGE i.S. Von Roll, BGE 122 IV 103. The overall notion is of the company’s board and senior management having special liability in their role as the highest authority in the company (“Geschäftsherrenhaftung”). For a relevant criminal administrative law provision, see Article 6, Paragraph 2 of the VStrR.

As the highest organ in the company, the board, under this view, must be watchful that appropriate means are in place to reduce the chances of breaches by others at the company. The growing prospect of corporate or individual liability creates an incentive for greater rigor by the board to provide such oversight than in the past.

Swiss courts interpreting criminal law have provided further definition in more recent times. For example, in two related cases involving allegations of corruption, the court's decision would imply that the duty under relevant corporate liability provisions¹⁸ also includes making use of specific preventive compliance techniques, such as conducting risk reviews of third-party agents and providing anti-corruption training to relevant employees.¹⁹ This type of reasoning — that, in effect, implies an ongoing duty by the board to keep up with emerging good compliance practices — shows similarities to developments in other jurisdictions, including those defining what constitutes an effective compliance program under provisions relating to criminal law²⁰ or other specific laws.²¹

Financial Services Regulation Context

Although of significant value, the above developments in Swiss criminal and administrative law still fall short on specificity for the means of providing successful board oversight in compliance. Far more guidance

¹⁸ Swiss Criminal Code, Article 102, Paragraph 2. This is the provision that creates corporate and individual criminal liability in certain circumstances. This article, however, has certain limits since it is not of general applicability but only in respect of certain acts relating to criminal organization, financing of terrorism, money laundering, and bribery of Swiss government officials.

¹⁹ In November 2011, the Swiss Attorney General ordered the Alstom Group to pay a fine of CHF 2.5-million and make disgorgement of CHF 36.4-million for failure to have proper procedures to prevent bribery of foreign officials. See, e.g., Livschitz, “Switzerland Enters the Anti-Corruption Enforcement Arena: Lessons from the Alstom Case”, 2012, at p. 6, see https://www.bakermckenzie.com/~media/Files/BDSUploads/Documents/global%20corporate%20compliance/nl_na_insidefc pawinter_jan12.pdf.

²⁰ For example, the United States Federal Sentencing Guidelines, see Footnote 51, *infra*.

²¹ For a United States example, with regard to environmental law, see “Compliance Monitoring Programs”, Environmental Protection Agency, see <https://www.epa.gov/compliance/compliance-monitoring-programs>; “Developing an Environmental Compliance Plan, see <http://lscdesignva.com/graphics/books/ENREG.pdf>. On the European side, see the European Commission’s “Compliance Matters”, at <https://publications.europa.eu/en/publication-detail/-/publication/78f46c48-e03e-4c36-bbbe-aa08c2514d7a/language-en>.

emerges from the regulations and supervisory guidance issued by Switzerland's financial services regulator, FINMA.

While FINMA's guidance applies only to those entities it supervises, the practical impact goes beyond. As financial services companies adjust to meet the FINMA expectations, their practices tend to become known in the broader Swiss marketplace and to influence how companies in other sectors think about and approach compliance.²² For example, FINMA carried out an extensive assessment in 2010 on governance, risk, and compliance practices among insurers. The results were noted publicly and even cited in other contexts, enriching the general discussion on topics such as whistleblowing, for example.²³

While FINMA had, in earlier regulation and circulars, made various articulations relevant to the board's oversight in compliance,²⁴ the clearest guidance emerges in two separate 2017 circulars.²⁵ One applies to banks and certain other financial entities²⁶ (the "Banking Circular") and the other to insurers (the "Insurance Circular"). These circulars

22 The influence sometimes can be more direct, such as in the case of an individual who is a member of the board of both a financial services company and a non-financial services company, or when compliance officers change sectors. Further cross-influences arise in professional associations. For example, while there is a bank-oriented compliance officers association in Switzerland, there is another that is multisector and includes compliance officers from the financial services and many other industries. See *op. cit.* at Footnote 116, *infra*.

23 The report was part of FINMA's first Swiss Qualitative Assessment or SQA I, 29 October 2010. This was followed by a second report on 3 April 2013, known as SQA II. These are available respectively at <https://www.finma.ch/de/dokumentation/finma-aufsichtsmittelungen/archiv/> and <https://www.finma.ch/de/suche/>. With regard to SQA's impact, see, e.g., Stefan Rieder, "Whistleblowing-Systeme bei schweizerischen Versicherungsunternehmen", in Jusletter, 15 July 2013, see https://www.bratschi.ch/fileadmin/daten/dokumente/publikation/2013/2013_Publikation_SRI_Whistleblowing-Systeme_bei_schweizerischen_Versicherungsunternehmen.pdf. See also IMF, Switzerland: Report on Observance of Standards and Codes, 2014, at p. 27, see <https://www.imf.org/external/pubs/ft/scr/2014/cr14144.pdf>. In the United States note was also taken of the SQA by the National Association of Insurance Commissioners, see https://www.naic.org/documents/committees_ex_isftf_orsa_consultation_paper.pdf.

24 Some of these are found in banking law and ordinances, others in circulars. See, regarding banks, FINMASA, Article 7, BA, Articles 3 and 6; BO, Articles 11 and 12. Regarding insurers, see ISA, Articles 4, 14, 22, 27, 67, 68, 75, and 76; and ISO, Articles 12–14, 16, 96–98, 191, 195–196, and 204. The predecessor of the current banking circular was FINMA Circular 08/24 and of the insurer circular FINMA Circulars Number 08/32 and Number 08/35, all from 2008.

25 FINMA Circular Number 2017/1, Corporate Governance — Banks; Circular Number 2017/2 Corporate Governance — Insurers, see <https://www.finma.ch/en/documentation/circulars/>.

26 This also applies to securities dealers, financial groups, and certain financial conglomerates. See FINMA Circular Number 2017/1, Line 1.

differ in a number of ways, but both foresee, directly or indirectly, more than a passive role by the board in compliance oversight.

The Banking Circular is direct in emphasizing the principle that the board is a “governing body” whose duties include providing “supervision and control”.²⁷ The kind of supervision and control the board is expected to provide is clarified further in that the Banking Circular requires the board to have an Audit Committee and expects this committee to “monitor the effectiveness of the internal control system”. FINMA leaves no doubt on the scope: it defines an internal control system explicitly as including, among other things, a “compliance function”.²⁸

Although less detailed, these FINMA provisions draw considerably on the work done after the financial crisis by key international standard setters.²⁹ For example, the governance principles of the Basel Committee on Bank Supervision (referred to here as the “BCBS Principles”) provide that “the bank’s board of directors is responsible for overseeing the management of the bank’s compliance risk”. They go on to specify that the board should approve the bank’s policies and processes for identifying, assessing, monitoring, reporting, and advising on compliance risk.³⁰

The BCBS Principles foresee clearly an active role by the board in the oversight of compliance, not simply one where the board takes note of management’s activities on the subject. This is an approach that is increasingly evident among the larger Swiss companies, even those not subject to banking regulation.

For example, the board of Swiss Re, a global reinsurer, carries out an annual assessment to measure their company’s governance and related practices against “recognized best practices”, including those outside of Switzerland and those emerging from international studies.³¹

²⁷ FINMA Circular Number 2017/1, Line 9.

²⁸ FINMA Circular Number 2017/1, Line 37.

²⁹ FINMA in fact was represented in the post-financial crisis governance, risk, compliance, and incentives work of the key international standard setters, including the Financial Stability Board, the Basel Committee on Bank Supervision, the International Association of Insurance Supervisors, the Joint Forum, and the Organization for Economic Cooperation and Development (OECD).

³⁰ Similar expectations are set out in Article 7 of the Insurance Core Principles of the International Association of Insurance Supervisors, see <https://www.iaisweb.org/page/supervisory-material/insurance-core-principles>.

³¹ Swiss Re, “Our Approach to Corporate Governance”, see http://www.swissre.com/about_us/swissre_group/corporate_governance/.

Its Audit Committee defines its role as including oversight not only for “the integrity of the Group financial statements” but for “compliance with legal and regulatory requirements”. Toward this end, the Group’s Chief Compliance Officer reports regularly to the Audit Committee and is even a regular invitee to its meetings.³²

The consequences when a board fails to provide the above type of compliance oversight³³ were highlighted in a recent case involving a major bank serving primarily the Swiss local retail market. In that case, the alleged compliance breaches in question were by the bank’s own CEO. In its findings, FINMA concluded that “the board of directors ... failed to adequately perform its function as the body responsible for overall managing, supervising and controlling the bank ... The board neglected its duty to oversee the CEO by failing to enforce compliance with internal regulations”.³⁴

Beyond providing oversight, another emerging international expectation is for the board itself to be a source of leadership on compliance. Often expressed under the rubric of “tone-at-the-top”,³⁵ the notion is that the board helps foster the ethical climate at the company. This can be a climate where the company’s ethics are not in the forefront, or where they are situational and dependent on the business gain to be had; alternatively, a climate where there is clarity on the company’s values, and priority is given to testing corporate practices and decisions against these values.³⁶

Consistent with the growing international interest in this area, FINMA included this topic in a first industry-wide assessment of insurers in 2010.

32 See http://media.swissre.com/documents/corporate_governance_en.pdf.

33 Of course, the board’s oversight duties are not only in respect of compliance. For a larger view, see Varges, “Internal Governance: The Next Frontier” in Ethical Board Room, Spring 2017, see <https://ethicalboardroom.com/internal-governance-the-next-frontier/>.

34 For FINMA’s findings, see <https://www.finma.ch/en/news/2018/06/20180614-mm-raiffeisen/>. Among the governance shortcomings found was the fact that, for a time, the legal function, which was also responsible for compliance, included and at a later point was headed by an employee with whom the CEO was romantically involved and who would later become his wife.³⁴

35 Financial Stability Board, “Strengthening Governance Frameworks to Mitigate Misconduct Risk”, see <http://www.fsb.org/wp-content/uploads/P200418.pdf>.

36 The OECD describes this as follows: “Board members should set the ‘tone at the top’ by establishing and promoting a proper risk culture and ethical and sound control environment, and by leading by example.” OECD “Guidelines on Insurance Governance”, 2017, see <http://www.oecd.org/finance/insurance/48071279.pdf>. Regarding the importance of values, also during difficult times, see Varges, “Managing Ethics and Compliance in Times of Economic Turbulence”, in *Ethikos*, Volume 22, Number 3, December 2008.

The regulator found that boards were demonstrating “insufficient prominence in setting or being part of the tone-at-the top”. In subsequent guidance, FINMA has expressed that it also expects management to provide the right “tone”.

In 2017, FINMA stated that tone-on-the-top means that “senior management members must be role models and live out the company’s culture and risk posture in their own personal conduct”.³⁷ Both of the above articulations, however, miss the opportunity to make another important connection: that the right tone also is definable by how well the company’s leadership advocates for and supports having the right means to operationalize compliance.³⁸

Compliance Function

In General

As argued in the foregoing section, the understanding is solidifying that the board’s role also includes advancing the operational means to bring about better compliance. This serves as a doctrinal and practical bridge to another major development in Switzerland: rising acceptance of the need to have an actual compliance function. While the practice is still in development, it can be expected to continue. It is consistent with the international thinking in this area that a dedicated compliance function, while by itself not sufficient for effective compliance in a company, is instrumental for the goal.

Earlier views tended to underplay this need. One common argument was “why would a company need a compliance function if it already has a legal department?” Another common objection was that if a company created a compliance function, this would somehow cause management

³⁷ *Erläuterungsbericht zu Rundschreiben 2016/xx “Corporate Governance — Banken”*, see <https://www.finma.ch/en/news/2016/03/20160301-mm-rs-corporate-governance-bei-banken/>.

³⁸ Interview of G. S. Varges: “The tone from the top is critical but insufficient without the right supporting compliance infrastructure to execute and work on all levels of the culture. Employee credibility can be lost if the right tone is not accompanied by evidence of robust structures and initiatives”, “Corporate Counsel Tackle The Challenges Of Global Compliance”, *Metropolitan Corporate Counsel*, 1 May 2005. Unfortunately, recent evidence suggests that boards still fall short in this area. LRN, “The Role of Boards in Overseeing Corporate Ethics and Compliance”, 2018, see <http://lrn.com/news-archive/boards-of-directors-study/>.

(and potentially the board) to feel less accountable for compliance under the motto “We can relax; the Compliance Department now takes care of compliance, not us”.

As to the first point, practice among Swiss companies reflects growing comfort that a dedicated compliance function a) makes governance sense and b) adds value that is different though complementary to the value a legal function generates.³⁹ A prerequisite for this recognition is appreciating the significant difference between serving as an in-house counsel versus as a compliance officer.⁴⁰

One difference stems from the contrasting type of activity between the two roles: the legal counsel is more weighted toward advising management on legal and contractual obligations and providing legal support on commercial and corporate transactions, whereas the compliance officer is principally oriented toward driving implementation and increasing the quota of compliance against regulatory and internal policies. This can include putting in place training programs for employees, designing processes, embedding controls, and monitoring compliance. It also can include serving as an enterprise-wide champion for the agreed-upon corporate values.

Another difference from the legal counsel and the compliance officer roles stems from an expectation that is more heightened in the case of a compliance officer: the expectation to serve as an additional governance check-and-balance *vis-à-vis* management. Rather than being an instrument of management, the compliance officer is increasingly expected to provide independent assurance to the board.⁴¹ In fact, this governance role also allows the compliance function to provide healthy challenge when needed to other functions, including the legal

39 Following a significant compliance incident, a major Swiss asset management company announced recently that “the compliance and legal functions were separated to underscore the importance of compliance, with the group head of compliance also joining the Group Management Board”. See, GAM Press Release, 28 August 2018, at <https://globenewswire.com/news-release/2018/08/28/1557271/0/en/GAM-outlines-liquidation-plan-for-unconstrained-absolute-return-bond-funds.html>.

40 One reflection of this is that formal legal studies are no longer an absolute prerequisite for many compliance positions. There is growing recognition of the interdisciplinary nature of compliance and that a compliance function benefits from a variety of skills and backgrounds among its staff, not only of the legal type.

41 This distinction is one which even senior management still are working through to understand. Varges, “Working with the Chief Compliance Officer: A New CEO Skill”, in *European CEO*, January 2013, see https://www.dropbox.com/s/fvam20vf9wjsm91/HCM_Working%20with%20the%20CCO%20A%20new%20CEO%20skill_Jan2013.pdf?dl=0.

department. Significant cases have occurred where an effective ethics or compliance counterweight to the legal function might have helped make better corporate decisions.⁴²

It is thus not surprising that both FINMA circulars specifically speak of the need to have a “compliance function”. The Banking Circular sets out a number of minimum responsibilities for this function and requires at least annual reporting to the board.⁴³ The Insurance Circular is briefer on the responsibilities of the compliance function but also requires it to report annually to the board.⁴⁴

The forces influencing these formulations stem in large measure from developments among international standard setters, as well as from the European Union (EU).⁴⁵ Even prior to the financial crisis, the BCBS had set out various expectations for banks for addressing compliance, including having a compliance function.

One standard from 2005 specifies: “First, the compliance function should have a formal status within the bank”. This characteristic is of importance as it suggests it cannot be simply an *ad hoc* function or some

42 A recent such case involved a major Swiss company where the general counsel reportedly signed off, or may have had further involvement, in a decision involving certain payments in the United States to the former lawyer for then-candidate Donald Trump. The decision resulted in his resignation. “Novartis General Counsel to Step Down After Cohen Payments”, in Bloomberg, 16 May 2018, see <https://www.bloomberg.com/news/articles/2018-05-16/novartis-says-general-counsel-to-retire-after-cohen-payments>. One report suggests that an individual promoted from within to deal with ethics may have also not dealt with the matter ideally. See “Actares verliert den Glauben an die Wirksamkeit der Compliance-Regeln von Novartis”, 16 May 2018, at <http://www.actares.ch/de/index.php/dossiers/companies/novartis/article/actares-loses-faith-in-the-effectiveness-of-novartis-compliance-rules/>. On 14 August, the company announced the appointment of an externally recruited new Chief Compliance Officer whose position is now elevated to the company’s Executive Committee. See <https://www.novartis.com/news/media-releases/novartis-appoints-dr-klaus-moosmayer-chief-ethics-risk-and-compliance-officer>. These observations should not be interpreted as diminishing the critical role that an effective legal department plays. In fact, one could argue that the legal function also serves a check to all other functions at the company, including compliance, by ensuring that their activities are properly legally-informed.

43 FINMA Banking Circular 2017/1, Lines 77–81, Corporate Governance — Banks.

44 FINMA Insurance Circular 2017/2, Lines 42 and 23, Corporate Governance — Insurers.

45 For example, both under the EU MiFID and MiFID II Regulations, companies subject to them must have an independent compliance function and a compliance officer to head it. See, “The Compliance Function Under MiFID II”, <https://www.lexology.com/library/detail.aspx?g=2cc0651a-763a-4b79-8418-40e4d43a70c4>.

kind of sub-activity whose ownership and governance standing is unclear. The BCBS standard goes on to say:

“There should be a group compliance officer or head of compliance with overall responsibility for coordinating the management of the bank’s compliance risk”.⁴⁶

The latter principle also is significant. It suggests that there must be a central compliance officer that can have an enterprise-view of compliance. Simply having a series of disconnected local compliance officers would not suffice in the case of a group.⁴⁷

In the above context, while United States compliance practices have had significant impact in Switzerland in other respects,⁴⁸ on the specific notion of a distinct compliance function the influence has been less pronounced. This is so because a main driving force in the United States on compliance has been the United States Federal Sentencing Guidelines that formally remain agnostic on the notion of a compliance function *per se*. The emphasis in the guidelines⁴⁹ is not on having a compliance function but a “compliance program”.

The latter can be interpreted in varying ways, but it does not necessarily lead to the conclusion of specifically requiring a compliance function. On the other hand, it is helpful that these guidelines do specify the need to have “specific individual(s) within the organization” to have “day-to-day operational responsibility for the compliance and ethics program”. However, “individual” is not the same as function, and the

46 Standard 20, BCBS, Compliance and the Compliance Function in Banks, April 2005, see http://www.fsb.org/2005/04/cos_050426/.

47 Not answered, however, is whether the central or group compliance officer manages directly all the compliance officers within the group.

48 For example, Switzerland is now considering the potential introduction of United States-styled deferred prosecution agreements (DPAs). These have had considerable success in the United States and the UK, among other countries, in having companies make substantial changes to their compliance systems as part of the conditions for deferring the prosecution or fine, or suspending them all together if the conditions are met. The DPA proposal in Switzerland has elicited considerable debate. For the pros and contras, see https://www.admin.ch/ch/d/gg/pc/documents/2914/Organisationen_Teil_1.pdf.

49 The elements in these guidelines are meant to incentivize companies to take preventive and detective steps on compliance so as to potentially receive reduced sentencing in the event of a criminal violation and conviction. Available at <https://www.ussc.gov/guidelines>.

words “compliance function”, “chief compliance officer”, or “compliance officer” are not defined as such directly in the guidelines.⁵⁰

To be sure, it could be argued that the United States guidelines have an advantage in that they provide companies more alternatives to meet the test without creating a compliance function, such as by simply designating one of the regular in-house counsel as the person having “day to day responsibility” for compliance.⁵¹ While adding flexibility, the

⁵⁰ The relevant provisions of the Federal Sentencing Guidelines are: Chapter 8, Section 2.8.2.1, “Effective Compliance and Ethics Program”, see <https://www.ussc.gov/guidelines/2016-guidelines-manual/2016-chapter-8>. In practice, leading companies in the United States are migrating toward having a distinct Compliance Officer, Ethics Officer, or a combination of both. However, where such person should be housed — whether in a distinct function or as part of the legal department — remains subject to heated debate among academics and practitioners. See, for example, “Independence Day: The Separate and Equal Compliance Department”, 26 June 2016, see <https://globalcompliancenews.com/independence-day-the-separate-and-equal-compliance-department/>; Donna Boehme, “When Compliance and Legal Don't See Eye to Eye”, *Corporate Counsel*, 8 May 2014; Perigrine, “New Guidance on Compliance Officer Independence”, *AHLA Weekly*, 10/31 14; Heineman, “Can the Marriage of the GC and the Compliance Officer Last?”, 30 March 2012, *Corporate Counsel*, available at http://www.law.harvard.edu/programs/corp_gov/articles/Heineman_CorpCon_03-30-12.pdf; DeStefano, “Creating a Culture of Compliance: Why Departmentalization May Not Be the Answer”, 2014, see https://repository.law.miami.edu/cgi/viewcontent.cgi?article=1054&context=fac_articles. For further expressions of the debate, see Varges, “Compliance Case Studies”, in Basri (ed.), *Corporate Compliance Practice Guide: The Next Generation of Compliance* (2017). See Cases 2, 3, 17, 18, and 31.

⁵¹ The United States Department of Justice also hesitates on making specific prescriptions. Over time it has made various suggestions that the issue of whether to have a separate compliance function or to whom it should report should be situational and “tailored to a company's circumstances”. Shuchman, “DOJ Wants Compliance Independent, Corporate Counsel”, 29 October 2014, see <https://www.law.com/corpcounsel/almID/1202674971997/?kw=DOJ%20Wants%20Compliance%20Ind%20ependent%2C%20If%20Not%20Separate&et=editorial&bu=Corporate%20Counsel&cn=20141030&s%20rc=EMC-Email&pt=Daily%20Alert>. At the same time, in corporate integrity agreements (CIAs) or deferred prosecution agreements (DPAs), the relevant United States authorities have stipulated in various cases that the compliance function should be separate from the legal department or at least not report to the General Counsel. In a case involving the drug company Pfizer, for example, the regulator stipulated as part of the settlement that the compliance function should no longer “be subordinate” to the General Counsel. Instead, the head of compliance was required to report directly to the CEO, with separate reporting obligations to the board. Corporate Integrity Agreement between the Office of the Inspector General, HHS, and Pfizer, 31 August 2009; Section II.A, 1 and 2. Switzerland is examining proposals to introduce into law the practice of DPAs, though it is not clear whether the intention would include allowing authorities to prescribe specific compliance organizational prescriptions as part of the conditions for fulfilling the DPA.

United States guidelines at the same time fall shy of those international standards that offer clearer guideposts in the above regard.⁵²

A second common objection to having a distinct compliance function is that it could have the unintended effect of disenfranchising others from their own compliance duties. A particular concern is that, with a compliance function in place, management may feel less accountable for compliance. It could even give rise to situations where, if a compliance failing takes place, management shifts the blame to the compliance function.

These concerns reveal a degree of misunderstanding of the intent and role in practice of an effective compliance function. For neither in theory or practice is the objective in having a compliance function to absolve management from their duties or accountabilities in the area.⁵³ On the contrary, one of the benefits of an effective compliance function is that, by being able to focus 100 per cent on the company's preparedness and performance on compliance, it has a better chance of identifying shortcomings and pushing management to react.

It should be recalled that management's lapses on compliance are not always due to ill intent. They sometimes may be traced to lack of time, inattention, or preoccupation with other priorities. A strong compliance function can help management stay focused on matters that may appear more mundane but are important from a long-term perspective. This includes initiatives such as training, on-going communications, and other necessary "compliance maintenance".

A robust compliance function also can help management better prioritize risks. For example, it can frame and keep on the front burner critical compliance issues, such as the risks of competition law breaches,⁵⁴ when these may appear less compelling to a management

52 The issuers of the voluntary but highly influential Swiss Code of Best Practice on governance have also recognized the need for a "compliance function". However, they split the difference by qualifying that "the compliance function can be organised separately or integrated into other support functions, provided . . . necessary independence and coordination are ensured". *Economiesuisse*, "Fundamental of Compliance Management", September 2014, Principle 2, at p. 6, see <https://www.economiesuisse.ch/de/publikationen/fundamentals-effective-compliance-management-2014>.

53 The IAIS in fact explicitly rejects this point, setting out that: "The existence of control functions does not relieve the board or Senior Management of their respective governance and related responsibilities". Insurance Core Principles, ICP 8.3.2.

54 In 2018, the Swiss competition authorities issued a multimillion fine to several construction companies for price fixing. The case highlights the need also for small and mid-size companies to go beyond procuring legal advice and to actually implement

team busy with meeting yearly financial goals. Furthermore, the compliance function also can help detect violations and ensure the application of proportionate disciplinary measures when appropriate.⁵⁵ In other words, if designed and operating properly, an effective compliance function enhances, not reduces, management accountability.

Independence, Authority, and Resources of Compliance Function

For a compliance function to be effective, a number of prerequisites apply. One relates to the independence and authority of the compliance function. One thing is to have a distinct compliance function and another is whether this function can carry out its duties without interference and has the necessary powers to cause the company to take the necessary preventive and remedial actions.

Internationally, these challenges tend to be tackled through four discernible standard-setting strategies. The first strategy is reflected in the BCBS Principles that set out that the board, not management, creates the compliance function. From this vantage point, the compliance function is endowed from the very start with the board's imprimatur, giving it thereby a special standing different from management and arguably from other functions (e.g., the legal department). This approach is different from the United States Federal Sentencing Guidelines that, in this regard, simply require the person with day-to-day responsibility for compliance to have the ability to access "the governing authority or an appropriate subgroup of the governing authority".⁵⁶

That the board creates the compliance function also is of significance from a governance perspective. It suggests that the powers of the compliance function are derived from the board, not from management. As such, it would be more difficult for a new CEO, for example, to attempt to interfere with the work of the compliance function or curtail its field of play.

In Switzerland, FINMA does not go as far. While consistent with the international approach in emphasizing the need for an "independent" compliance function, FINMA actually shifts the focus back to management by requiring that someone on the company's executive committee "be

(footnote 54 continued from previous page)

concrete compliance techniques to operationalize that advice. It also raises the need for better protection of whistle-blowers. See "Preisabsprachen im Bündnerland: Das sagt der Weko-Präsident zum Baukartell-Skandal", SFR News, 12 May 2018.

⁵⁵ For example, FINMA specifies that the compliance function, among other things, must "assess how the company deals with compliance breaches". FINMA Insurance Circular 2017/2, Line 42, Corporate Governance — Insurers.

⁵⁶ United States Federal Sentencing Guidelines, Chapter 8B.21(b)(2)(c).

responsible” for compliance.⁵⁷ At the same time, FINMA makes it clear that the compliance function must be separate from operational management. Thus, FINMA draws a distinction between senior most management and those managers “in revenue generating units”.⁵⁸ Similarly, Swiss courts have articulated that being independent from the *Geschäftsbetrieb* or the business operations is an important characteristic for a compliance function.⁵⁹

A second strategy for enhancing the compliance function’s independence and authority is by positioning it as an indispensable component of the so-called “Three Lines of Defense”.⁶⁰ As it has evolved and spread internationally, this model also has generally found acceptance in Switzerland.⁶¹ This model recognizes compliance as part of the Second Line serving as a check *vis-à-vis* management, which is in the First Line. Thus, the BCBS Governance principles specifically state that “the second line of defense . . . includes an independent and effective compliance function”.⁶² Noteworthy is that the legal department is not normally deemed part of the Three Lines of Defense, signaling that its role, though no less valuable, is simply different from that of the so-called control functions, which includes compliance.⁶³

A third strategy for helping advance the authority and independence of the compliance function is setting standards that go beyond the generic or the vague (such as “a compliance function assists management on compliance”). Instead, standard setters and some regulators recognize

57 FINMA Banking Circular 2017/1, Line 65, Corporate Governance — Banks. However, FINMA still requires the compliance function to have “direct access” to the board, Line 66.

58 FINMA Banking Circular 2017/1, Line 64.

59 See Hahn, Livschitz et al. “Compliance in der Schweiz”, *Compliance Aktuell*, November 2016, at p. 3.

60 See, for example, “The Three Lines of Defense in Effective Risk Management and Control”, Institute of Internal Auditors, January 2013, at <https://na.theiia.org/standards-guidance/Public%20Documents/PP%20The%20Three%20Lines%20of%20Defense%20in%20Effective%20Risk%20Management%20and%20Control.pdf>. Some have sought adjustment to also include a role for the external auditor and/or the regulator in the model. See, e.g., Financial Stability Institute, “The Four Lines of Defence”, December 2015, at <https://www.bis.org/fsi/fsipapers11.pdf>.

61 Most recently, an asset management company that experienced a compliance event made explicit reference in its press release to the fact that it “operates a standard three lines of defence model”. See GAM Press release 28 August 2018.

62 BCBS Governing Principles, Paragraph 40.

63 The Three Lines of Defense Model is not without shortcomings. For example, it underplays the role of the board and creates a level of confusion with regard to which level of management is in the First Line and which not. A critique is provided in Varges, “The Three Lines of Defense and Risk Culture”, Presentation to the Financial Stability Institute, Bank for International Settlements, 6 December 2017.

the benefit of providing some framework for the compliance function and some indication of the the expected activities.

For example, the EU requires, under MiFID II, that the compliance function run a risk-based monitoring program and report regularly thereon. The compliance function also is expected to form a view and report annually on the overall control environment of the company. This last responsibility is noteworthy, for the possibility exists that the compliance function's conclusions on the company's control environment could differ from those of management. Without the compliance function having the right level of independence or authority, it might not be able to deliver as candid an assessment to the board, depriving the board thereby of the opportunity to have a more complete perspective on the state of compliance at the firm.

It is perhaps for this reason that the International Association of Insurance Supervisors (IAIS) standards make the board responsible for the compliance function having the right independence and authority. They specify that the board should "approve the authority and responsibilities" of the compliance function.⁶⁴ This is to include giving the head of the compliance function:

"... the authority and obligation to inform promptly the Chair of the board directly in the event of any major non-compliance by a member of management or a material non-compliance by the insurer with an external obligation, if in either case he or she believes that Senior Management or other persons in authority at the insurer are not taking the necessary corrective actions and a delay would be detrimental to the insurer or its policyholders."⁶⁵

These and other similar international principles advance considerably what it means for a compliance function to have "adequate" independence and authority. FINMA in Switzerland covers similar ground, but with some twists. First, it emphasizes the right of the compliance function to "have unlimited information, access, and inspection rights" and to "direct access" to the board.⁶⁶ It then sets out expectations for the compliance function, including making an "independent assessment" of

⁶⁴ Insurance Core Principles of the International Association of Insurance Supervisors, ICP 8.3.6.

⁶⁵ Insurance Core Principles of the International Association of Insurance Supervisors, ICP 8.5.5.

⁶⁶ FINMA Banking Circular Number 2017/1, Lines 64 and 66, Corporate Governance — Banks.

the “key compliance risks” and reporting thereon periodically (“at least annually”) to the board.⁶⁷ It also requires the compliance function to “report serious compliance breaches”. However, this reporting must be both to the board and to senior management. Conceivably, the latter requirement could make it awkward for the compliance function to report to the board on matters that implicate management.⁶⁸

Another international standard merits separate attention. In the IAIS Principles, the board is tasked with ensuring that the compliance function does “an assessment of how the various business units are performing against internal control standards and goals”.⁶⁹ This expectation is of considerable weight. In effect, it empowers the compliance function to dig into how well the various parts of the business are doing on compliance.⁷⁰ Together with the compliance function’s obligation to “address compliance shortcomings and violations, including ensuring that adequate disciplinary measures are taken”, this standard provides the compliance function strong wherewithal to look beyond the surface and assess and compare the performance of the various parts of the business.

A fourth strategy by standard setters for breathing more life into the compliance function’s independence and authority is addressing the prickly question of resources. The issue is not without difficulty. In general, standard setters and regulators are hesitant to be prescriptive on how a company allocates its budgets and personnel.⁷¹ Nonetheless, it would frustrate all other goals for empowering the compliance function if, despite formal independence and authority, this function lacked the resources necessary to provide its services and successfully carry out its mission.⁷²

International standard setters initially treaded lightly in respect of resources. For example, in 2006, the BCBS made only indirect reference to resources. It commented on the importance of control functions (including compliance) being staffed with “competent” and “qualified”

67 FINMA Insurance Circular, Number 2017/1, Line 43, with a comparable provision in the Banking Circular, Line 80.

68 FINMA Banking Circular, Number 2017/1, Line 81.

69 Insurance Core Principles of the International Association of Insurance Supervisors, ICP 8.2.8.

70 Varges, “The Subsidiary Governance Challenge”, *Ethical Boardroom* (November 2015), see <https://ethicalboardroom.com/the-subsiary-governance-challenge/>.

71 Varges, “Emerging International Indicators for Compliance Function Expectations”.

72 Varges, “Budgeting and Cost Control Strategies and the Compliance Program”, *Corporate Compliance Practice Guide: The Next Generation*.

personnel.⁷³ To have such personnel, of course, would imply having enough budget for this purpose. However, the standard does not address the many other types of resources — such as information technology and access to external experts when needed — which a compliance function must be effective.

More recently, international standard setters have recognized this shortcoming. For one, some require the board to oversee the resources of the compliance function.⁷⁴ This permits the board to pose critical questions on the adequacy of these resources. Other authorities see the test for adequate resources to be whether they are at a level “necessary” for the compliance function “to fulfil its responsibilities and achieve the specific goals in its areas of responsibility”.⁷⁵

Another approach to addressing the resource quandary is to include the compliance function itself in the assessment of resource sufficiency. The IAIS Principles, for example, set out that the head of the compliance function: “. . . should review regularly the adequacy of the function’s resources and request adjustments from Senior Management as necessary”.⁷⁶ The standards also set forth a dispute settlement mechanism. Where the head of compliance “has a major difference of opinion with Senior Management on the resources needed”, he or she can “bring the issue to the board or relevant board Committee for resolution”.⁷⁷

In the United States, the Federal Sentencing Guidelines were revised in 2004 to specify that the person carrying the day-to-day responsibilities for compliance should receive “adequate resources”.⁷⁸ While this guidance is very general, clearer hints can be found in certain Securities Exchange Commission (SEC) cases. For example, in one case dating back to 1986, the SEC found a broker dealer liable in part for lacking sufficient resources for the compliance function. Pursuant to the

⁷³ BCBS, Enhancing Corporate Governance for Banking Organizations, 2006, Principle 5, see <https://www.bis.org/publ/bcbs122.htm>.

⁷⁴ The OECD, for example, sets out that the board should oversee “mandate, scope of activities, authority, independence, and resources” of the compliance function. OECD Guidelines on Insurance Governance, 2017, at p. 13.

⁷⁵ IAIS — Insurance Core Principles of the International Association of Insurance Supervisors.

⁷⁶ IAIS — Insurance Core Principles of the International Association of Insurance Supervisors.

⁷⁷ IAIS — Insurance Core Principles of the International Association of Insurance Supervisors.

⁷⁸ United States Federal Sentencing Guidelines Manual, 8 B2a(b)(2)(C), *op. cit.* at Footnote 50, *supra*.

settlement, the broker dealer agreed, among other things, to increase ratio of compliance officers to account executives.⁷⁹

Switzerland took note of the international debate on resources, and as early as 2009 began probing in this area. FINMA polled insurers on the level of resources employed in the governance, compliance, and related areas. The results of this review suggested that at some firms there was underinvestment on compliance. In a subsequent review in 2013, FINMA found that some companies may not “have incorporated sufficiently in their business model and financial planning the necessary costs of appropriate” compliance-promoting activities. It also offered two observations that provide further insight as to why appropriate resources are essential for an effective compliance function:

- (1) Insufficient resources can result “in severe pressures” on the compliance function “to perform”, while lacking the means for it; and
- (2) Insufficient resources could result in compliance functions “reducing their scope or intensity of efforts”.

FINMA also found that, at some companies, the compliance function has “limited say or influence on the resources they deem necessary to carry out their assigned tasks and responsibilities”; internal spending relating to compliance is not tracked; and “Information on budgets, resources, and other investments” relating to compliance is not always “sufficiently reported to the [board] such that it can provide oversight and approvals where appropriate”.

FINMA’s Banking Circular treats the issue of resources in the direction of many international standard setters. It provides that part of the board’s responsibilities is “ensuring that the institution has appropriate levels of personnel and other sources”. Later, it is explained that, with respect to the control functions, including compliance, they must be provided “with the necessary resources and powers”.⁸⁰ FINMA also requires the compliance function to report to the board annually on “the activities of the compliance function”.⁸¹

This last requirement has two advantages. First, it does not restrict the compliance function to report only on so-called “exceptions” (i.e., violations, problems, and so on). It implies that it also can report on

⁷⁹ The case is *First Affiliated Securities*, Exchange Act Release 2335, 35 SEC Docket (CCH) 1172, 18 June 1986. Varges, “Emerging International Indicators for Compliance Function Expectations”, at p. 6.

⁸⁰ FINMA Banking Circular, Lines 13 and 64.

⁸¹ FINMA Banking Circular, Line 80.

preventive activities. Second, since it permits reporting on “activities”, it provides the compliance function an opportunity to explain to the board how the management allocated resources impact those activities and, if needed, to advocate for more.

Scope of Compliance Function

The effectiveness of a compliance function also is dependent on how its responsibilities are defined. If they are drawn too narrowly (for example, only to cover money laundering or fraud), the compliance function will be powerless in the face of other potential compliance or conduct risks. The perils of too narrow a scope also can arise if the compliance function is restricted to addressing only legal or regulatory issues.

While not taking on these issues directly, the Financial Stability Board has been instrumental in raising awareness on the importance of looking beyond technical compliance. It has given emphasis to the need to also examine an institution’s corporate culture and the means it uses to promote good conduct.⁸²

Another standard setter, the BCBS, has expressed that pursuing good corporate governance includes aligning “corporate culture, corporate activities and behavior with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations”.⁸³ In addition, it calls for banks to have “a written code of ethics or a code of conduct”, specifying that such a code “is intended to foster a culture of honesty and accountability to protect the interest of its customers and shareholders”.⁸⁴

The IAIS has contributed to the thinking in this area too, by clarifying that going beyond legal or regulatory compliance is not only a company-wide need. It is a need also of the compliance function itself. It warns against a too-restrictive view of the compliance function’s scope:

“The compliance function has a broader role than merely monitoring compliance with laws and regulations and supervisory requirements. Monitoring compliance with internal policies and

⁸² Financial Stability Board, “Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture”, April 2014, see <http://www.fsb.org/wp-content/uploads/140407.pdf> and Strengthening Governance Frameworks to Mitigate Misconduct Risk.

⁸³ BCBS *Corporate Governance Principles for Banks*, 2015, “Introduction”, Section 3.

⁸⁴ BCBS *Corporate Governance Principles for Banks*, 2015, “Introduction”, Section 14.

promoting and sustaining a compliance culture within the insurer are equally important aspects of this control function.”⁸⁵

The IAIS adds that, to advance the right culture, the compliance function should engage in various activities, including “communicating and holding training on an appropriate code of conduct . . . that incorporates the corporate values of the insurer, aims to promote a high level of professional conduct and sets out the key conduct expectations of employees”.⁸⁶

FINMA in Switzerland has been cognizant of these international trends and has increasingly moved to also capture culture and conduct. In 2014, it issued a position paper⁸⁷ proclaiming “proper business conduct by financial institutions” as “being more important than ever”. In this regard, it sees “corporate culture” as one key element. In updating the Banking Circular three years later, FINMA added more precision by defining compliance as including “statutory, regulatory, and internal rules and observing generally accepted market standards and codes of conduct”.

The last assertion is far reaching. In not limiting the referenced “standards” to Switzerland, FINMA signals a continued preparedness to look at the international arena and take into account relevant developments abroad on compliance.

In addition, and significantly, the Banking Circular includes as part of the board’s duties “defining guiding principles for the institution’s culture”.⁸⁸ If the board also involves the compliance function on its work on corporate culture, this would align with those international standards that elevate culture to the board level and expect the compliance function to play a role therein.⁸⁹

Connection of Compensation to Compliance

The risks of too narrow a scope for the compliance function became evident during the last financial crisis. Neither risk nor compliance

⁸⁵ Insurance Core Principles, ICP 8.5.1.

⁸⁶ Insurance Core Principles, ICP 8.5.6.

⁸⁷ See https://www.finma.ch/FinmaArchiv/gb2014/download/2014/en/Artikel/Finma_AR14_Business%20conduct%20of%20financial%20institutions_En.pdf

⁸⁸ FINMA Banking Circular, Line 10. In the Insurance Circular, FINMA uses a different approach. It provides that good corporate principles include defining “principles relating to the conduct of employees” and that as part of an effective control system a company should include “awareness-raising among employees”. Insurance Circular, Lines 14 and 35.

⁸⁹ IAIS, Insurance Core Principles, ICP 7.2, which also explicitly charges the board to oversee the company’s culture.

functions had seen compensation as part of their responsibilities. Few examined or monitored whether the financial incentives of executives and other employees at the company themselves could constitute a source of risk.⁹⁰ Compliance functions typically did not even include in their annual work plans the review of the company's compliance with external rules on compensation or with the company's own internal policies on the subject.⁹¹

Following the financial crisis, the Financial Stability Board (FSB) was quick to address these shortcomings. It issued 2009 principles that have now become highly influential.⁹² These principles define parameters for regulators in the G-20 countries to integrate into local regulation or guidance on the subject.

A fundamental underlying principle in the FSB standards is that how compensation decisions are made is as important as the actual level of remuneration paid.⁹³ Thus, a major emphasis in the principles is the governance of compensation, including the expectation that the board play a direct and active role on the company's remuneration system (i.e., not just approve the level of compensation of the top executives, as many boards did in earlier times).

90 In the 2004 revision of the United States Sentencing Guidelines "incentives" were mentioned, although less in the sense of the risk which inappropriate pay structures could represent. They state: "The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through appropriate incentives to perform in accordance with the compliance and ethics program." Section 8B1.2 (b)(6). See Varges, "Should the Chief Ethics and Compliance Officer be Concerned with How His / Her Company Executives are Paid?", Presentation to the Society of Corporate Society and Ethics, London, 9 April 2013, see [https://www.corporatecompliance.org/Portals/1/PDF/Resources/past handouts/euroCEI/2013/Should_How_Executives_Paid_Concern_the_CECO_2slides.pdf](https://www.corporatecompliance.org/Portals/1/PDF/Resources/past%20handouts/euroCEI/2013/Should_How_Executives_Paid_Concern_the_CECO_2slides.pdf).

91 Varges, "Emerging International Indicators for Compliance Function Expectations". Varges, "Governing Remuneration"; Varges, "Incentives and Disciplinary Procedures to Promote and Protect the Compliance Program", in *Corporate Compliance Practice Guide: The Next Generation of Compliance*.

92 FSB, Principles for Sound Compensation Practices, April 2009, see http://www.fsb.org/wp-content/uploads/r_0904b.pdf?page_moved=1. Also of relevance are the accompanying standards; an update version is currently in consultation, June 2017, see <http://www.fsb.org/wp-content/uploads/R200617.pdf>.

93 The concern with the "how", not just the absolute amounts paid, creates the natural link to risk and compliance. Thus, while the market, shareholders, board of directors, and senior management are better positioned to determine the appropriate amounts to be paid, the risk manager and compliance officer can be of help in ensuring that compensation funding and allocation decisions take properly into account risk, compliance, and ethical considerations as well. See, e.g., Varges, "Governing Remuneration".

For example, the standards suggest board-led regular reviews of “the practical operation of the system”. This is to be done not only to check for “compliance with design policies and procedures”, but also to assess “compensation outcomes, risk measurements, and risk outcomes” to ensure “consistency with intentions”.⁹⁴

For the board to carry out such role, the FSB principles foresee the need for assistance from the independent control functions. Thus, in its Fifth Progress Report to the G-20 in July 2017, the FSB was able to report evidence of this taking place among banks in the 20 member countries:

- (1) “Independent control functions”, including compliance, are “providing “direct feedback to the Compensation Committee on executive officer performance”;
- (2) “Senior management and independent control functions” are annually “reviewing and certifying incentive plans”; and
- (3) “Independent control functions” are “collaborating on proposals for the design, operation, and monitoring of incentive compensation programs and taking part in formalized reviews that identify and evaluate events that may merit forfeiture or clawback”.⁹⁵

The FSB also has been instrumental in advancing the notion of connecting company and personal conduct to compensation plans. Under this view, institutions are encouraged to identify also non-financial metrics, including on compliance performance, upon which part of the senior management’s variable compensation is to depend.⁹⁶

In face of the above type of developments, FINMA reacted swiftly. Within a half year of the FSB publishing its principles, FINMA issued in 2009 principles (the “Remuneration Circular”) largely consistent with those of the FSB. This includes provisions regarding the primal role of the board on compensation and the need to risk-align pay. Though mentioned only briefly, it also includes the requirement for control

⁹⁴ FSB, Principles for Sound Compensation Practices.

⁹⁵ FSB, “Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards: Fifth Progress Report”, 4 July 2017, see <http://www.fsb.org/2017/07/implementing-the-fsb-principles-for-sound-compensation-practices-and-their-implementation-standards-fifth-progress-report/>.

⁹⁶ Varges, “Financial Stability Board Links Executive Compensation and Conduct, Ethical Board Room”, June 2015, see <http://www.hcm.com/de/aktuelles-publikationen/hcm-studien-und-viewpoints/>. FSB, “Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices”, 2018, at p. 15, available at: <http://www.fsb.org/wp-content/uploads/P090318-1.pdf>.

function involvement.⁹⁷ As last revised in 2017, the Remuneration Circular specifically provides that:

“The design and implementation of the remuneration scheme should be carried out in an impartial and objective manner. Human resources experts and control functions (e.g., risk management or compliance) should be involved to ensure a consistent design and implementation of the remuneration scheme across all business lines of a firm.”⁹⁸

The FINMA Remuneration Circular also requires an annual check on whether the bank is “in compliance with the board of director’s remuneration policy and the requirements of this circular”.⁹⁹ However, if compliance and other control functions are to be involved in assessing the soundness of the company’s compensation practices, then it is essential that their objectivity is not compromised through their own compensation arrangements.¹⁰⁰

Thus, another key FSB principle is that those in control functions “should be compensated in a manner that is independent of the business areas they oversee and commensurate with their key role in the firm”. While the first clause of this principle aims to avoid conflicts, the second one helps ensure that the control functions’ critical role is recognized and they are not underpaid relative to other important functions at the bank. Here, too, FINMA has taken note. The FINMA circular provides that:

“Remuneration schemes for control functions may not create incentives that lead to conflicts of interest with the tasks of these functions. The calculation of variable remuneration of these persons may not be directly dependent on the performance of the business units, specific products, or transactions these persons monitor”.¹⁰¹

⁹⁷ FINMA Circular 2010/01 on “Remuneration Schemes”, issued 21 October 2009, revised 2017, see <https://www.finma.ch/de/dokumentation/rundschreiben/>.

⁹⁸ FINMA Circular 2010/01 on “Remuneration Schemes”, issued 21 October 2009, revised 2017, Lines 27–29.

⁹⁹ FINMA Circular 2010/01 on “Remuneration Schemes”, issued 21 October 2009, revised 2017, Line 29.

¹⁰⁰ Varges, “Incentives and Disciplinary Procedures to Promote and Protect the Compliance Program”, *Corporate Compliance Practice Guide: The Next Generation of Compliance*.

¹⁰¹ FINMA Remuneration Circular, Line 59.

As to the level of pay of compliance and other control functions, FINMA goes less far than the FSB. It does not suggest the need to do any comparisons with other functions at the bank, though it does stipulate that the control functions' total compensation should be "sufficient in order to attract qualified and experienced persons".¹⁰²

The area of compensation and how it can impact conduct and other compliance goals — negatively or positively — is among the most fertile for exploration in the compliance field today. That some regulators are setting rules¹⁰³ is a strong reason for further focus in this area. However, even more compelling is the opportunity it offers for companies and compliance functions to go beyond command and control approaches.

It encourages exploring ways to nudge or even substantially shift organizational and individual behavior through well-designed and calibrated performance management and compensation systems.¹⁰⁴ To the extent that it also includes the means to reclaim compensation already paid out through so-called clawback mechanisms, this area also is among the most legally challenging.¹⁰⁵

Conclusion

The understanding of compliance in Switzerland has been evolving and continues to evolve. That this evolution can be understood in the backdrop of the country's international orientation is reflected also in the fact that the introduction to the Swiss Code of Best Practice begins with this reminder: "The Swiss economy is highly globalized and its

¹⁰² FINMA Remuneration Circular, Line 60.

¹⁰³ Such as those under the EU's CRD IV Directive. European Banking Authority, Remuneration, see <https://www.eba.europa.eu/regulation-and-policy/remuneration>. On how compensation also is part of a risk approach by regulators, see Raablaub and Varges, "Risk Orientation in Regulation and Supervision", *Journal of Regulation & Risk — North Asia*, Volume II, Edition I (Spring 2010), see <https://de.scribd.com/document/38461050/Journal-of-Regulation-Risk-North-Asia-Volume-II-Edition-I-Spring-2010>.

¹⁰⁴ See, e.g., Varges, "Financial Stability board Links Executive Compensation and Conduct". Varges, "Incentives and Disciplinary Procedures to Promote and Protect the Compliance Program".

¹⁰⁵ Varges, "Incentives and Disciplinary Procedures to Promote and Protect the Compliance Program."

value chains are becoming increasingly complex.”¹⁰⁶ Swiss companies have come to learn the hard way the extent of this complexity.

In the 1990s, Switzerland faced major legal challenges when it was criticized for allegedly not taking enough action to uncover the owners of dormant accounts in its banks and insurance companies, particularly those attributable to the families of holocaust victims.¹⁰⁷ The claims that were brought, including class actions in the United States, heightened the awareness of many Swiss companies of the need to give more attention to reputational risk and to the underlying legal, regulatory, and ethical issues that could give rise to it.¹⁰⁸

Swiss banks did have regulatory compliance units in earlier times, but these had tended to be more narrowly drawn and staffed with more junior personnel. Only in the late 1990s and in the early 2000s did the awareness across industries reach the point to trigger conceptual and organizational changes on how to approach compliance.

One start was the creation of distinct compliance functions at major Swiss multinationals and the appointment of senior-level global or “Group” Chief Compliance Officers to head them.¹⁰⁹ Another step was to no longer limit compliance functions to legal or regulatory matters. For example, Nestlé now describes compliance as including “legal and other obligations” and points to the aspiration of meeting “international standards”.¹¹⁰

Influenced by the global developments in compliance, both post-Enron and post the 2008 financial crisis, compliance functions in Switzerland continue today to evolve and make gains in those areas outlined in this article. This includes in general higher stature,¹¹¹ independence, authority,

¹⁰⁶ *Economiesuisse*, “Fundamental of Compliance Management”, September 2014, see <https://www.economiesuisse.ch/de/publikationen/fundamentals-effective-compliance-management-2014>.

¹⁰⁷ A brief update of the resolution of these issues is found in Swiss Info, “All Funds from Dormant Accounts Now Allocated”, 15 July 2013, see https://www.swissinfo.ch/eng/holocaust-scandal_all-funds-from-dormant-accounts-now-allocated/36460538.

¹⁰⁸ A further reminder were the series of tax-related cases brought by United States authorities against Swiss banks, particularly in 2008–2016.

¹⁰⁹ This included the Zurich Insurance Group (Zurich Financial Services) and Swiss Re and in later times companies such as Novartis, Nestlé, ABB, Credit Suisse, and Roche.

¹¹⁰ Nestlé, Compliance: “Clear Principles and a Strong Culture for Fair Business Practices”, see <https://www.nestle.de/unternehmen/grundsatz/compliance>. The italics are the author’s.

¹¹¹ In December 1998, the first major bank compliance organization was created, the Swiss Association of Compliance Officers (<https://www.complianceofficers.ch/>). In 2014, Ethics & Compliance Switzerland was launched as a platform for compliance professionals of all industries and sectors. See <https://www.ethics-compliance.ch/>.

and resources. Interest in the theory and practice of compliance is growing,¹¹² and the demand for highly qualified compliance professionals in the country is not abating.¹¹³

This notwithstanding, cases continue to arise that suggest that, despite the advances, compliance functions remain insufficiently effective.¹¹⁴ Moreover, cases like the FIFA scandals demonstrate the considerable challenges that compliance functions face when confronted with strong management figures.¹¹⁵ They also highlight that in Switzerland, as in other countries around the world, opportunities remain for generating more consistent responsible corporate conduct and more durable compliance outcomes.¹¹⁶

At the same time, there are positive signs of progress. For example, earlier this year a manager at one of Switzerland's weapon manufacturers

(footnote 111 continued from previous page)

Another example of the growing stature is the elevation to the Executive Committee in 2018 of the position of group head of compliance at a Swiss international asset management company. While other companies have had combination positions at such level (e.g., head of legal and compliance), this is the first time that a notable company in Switzerland positions a pure compliance role in the company's highest management body. Of significance too is that the new appointee to the position is a former regulator. "GAM Recruits Head of Compliance from FCA", *Investment Week* (12 March 2018), see <https://www.investmentweek.co.uk/investment-week/news/3028210/gam-recruits-head-of-compliance-from-fca>.

112 A number of Swiss universities and higher-education institutions now have more offerings relating to compliance. One example is an extensive curriculum for executives at the University of St. Gallen, where the author of this article teaches, focused on the practical means for managing compliance. See <https://www.es.unisg.ch/en/node/46>.

113 One reflection is that the compensation for compliance officers has been increasing, which at the most senior levels at Swiss multinationals can well exceed US \$500,000. Source: HCM International data.

114 This includes cases involving LIBOR where Swiss banks were among the list of banks around the world alleged to have colluded to illegally influence LIBOR rates. See "Tracking the Libor Scandal", *New York Times* (23 March 2016), at https://www.nytimes.com/interactive/2015/04/23/business/dealbook/db-libor-time-line.html#/#time370_10900.

115 See, "FIFA Compliance Chief Quits, Saying Corrupting Fighting Threatened", Bloomberg, 14 May 2016, at <https://www.bloomberg.com/news/articles/2016-05-14/fifa-compliance-chief-quits-saying-corruption-fight-threatened>.

116 Naturally, the ability of a compliance function to be effective depends also on the extent of support it receives from management and from the board. The ability of the board to provide such support also may be dependent on its own ability to be effective. Many factors influence board effectiveness. On how the board's own resources or lack thereof play a role, see Varges, "Do Boards Need Their Own Resources and Budget?" in L. Staub (ed.), *Beiträge zu aktuellen Themen an der Schnittstelle zwischen Recht und Betriebswirtschaft*, 2018.

allegedly was involved in the illegal sales of the company's products.¹¹⁷ The discovery was not made by the legal department, internal audit, or other traditional control mechanisms. Reportedly, it came to light by means of the whistleblowing line that the company had put in place as part of its compliance system.¹¹⁸

The above case reminds that the challenge in compliance is not about achieving perfect compliance (an illusory goal), but about constantly improving how we go about trying.¹¹⁹ In the case of Switzerland, a good deal of the improvement in compliance has come and will likely continue to come from its trying to be open to the more promising compliance ideas, whether they come from within or from outside the country.

¹¹⁷ The company is Ruag. See company press release, at <https://www.ruag.com/de/news/wegen-verdacht-auf-fehlverhalten-eines-mitarbeiters-straftanzeige-von-ruag-fuehrt-zu-hausdurchsuchung>.

¹¹⁸ As a non-EU member, Switzerland walks a careful line. While not subject technically to EU rules, Swiss companies follow closely EU developments to determine which may make sense to follow anyway, given the deep connection to EU markets and customers. One example of this is whistleblowing. NFK, "Whistleblower Protection: The Impact of the EU Commission's Proposed Directive on Whistleblower Protection on Swiss Legal Framework", see https://www.lexology.com/library/detail.aspx?g=75b7713a-bb0e-4b07-acc1ced3954d6cde&utm_source=lexology+daily+newsfeed&utm_medium=html+email+-+body+-+general+section&utm_campaign=acc+newsstand+subscriber+daily+feed&utm_content=lexology+daily+newsfeed+2018-07-23&utm_term.

¹¹⁹ The quote is inspired by the international compliance work by the distinguished negotiation and international law scholar and former Harvard University Professor, Roger Fisher. For an article written in his honor, see Varges, "The Compliance Side of International Legal Practice", *American Society of International Law, Careers in International Law*, 2002.

