# AFTER THE SPA: STUMBLING BLOCKS UNDER FATF – LOSS OF RIGHT TO DIVIDENDS IF NOTIFICATIONS ARE OMITTED, ALSO IN M&A TRANSACTIONS

In view of the draconian sanctions currently in force under company law (and possibly soon to come into force under criminal law), it is advisable for everyone to check carefully whether they trigger reporting obligations under company law when acquiring shares. On 20 March 2019, the Swiss National Council waved through the envisaged changes in criminal law; now it is the Council of States' turn.

At a recent closing of a smaller M&A transaction, our lawyers realized once again that business people, especially people who are not involved in M&A transactions every day, are often not aware of the so called FATF provisions. In view of the fact that their ignorance could have significant and possibly grave consequences, we would like to recall them as follows:

## FATF-Reporting obligations in the case of share purchases

On 1 July 2015, as part of the implementation of the recommendations of the financial action task force (FATF/GAFI) on combating money laundering and on improving transparency with regard to legal entities in the Swiss Code of Obligations (CO), art. 697i to art. 697m CO came into force for stock corporations (Ltd) and art. 790a CO for private limited companies (LLC).

Primarily the acquisition of shares of non-listed Swiss stock corporations that are not structured as book-entry securities, i.e. in particular participations in SME companies, are subject to the reporting obligations.

Art. 697i and art. 697j CO in certain constellations impose reporting obligations on any acquirer of shares; any non-compliance results in sanctions under company law. The iron rule of stock corporation law that shareholders are *ex lege* only subject to the so-called payment obligation is therefore no longer valid.

With regard to the *reporting obligations upon acquisition*, it is distinguished between the notification of the bearer shareholder (simple notification) and the notification of the beneficial owner of the (registered or bearer) shares (qualified notification). In either case, any transfer of shares within the framework of a legal transaction (such as an M&A transaction, but also e.g. in case of a gift), universal succession (merger,

inheritance), incorporation or capital increase is deemed an acquisition. The establishment of a usufruct also triggers a reporting obligation.

a) Simple notification: notification of the bearer shareholder

It should be noted that the number of bearer shares acquired is irrelevant; the reporting obligation under art. 697i CO already exists with the acquisition of *one* bearer share (and thus with each acquisition of a new bearer share). In addition, it also applies to shareholders holding bearer shares at the time the new law came into force - the grace period for the notification expired on December 31, 2015. As a consequence the previous anonymity of the bearer shareholder is no longer guaranteed. With regard to the draconian penalties for non-compliance with the reporting obligation, it is highly likely that the bearer share institution will disappear from practice in the longer run, even if the legislative efforts to abolish the bearer share turn out to be unsuccessful.

b) Qualified notification: notification of the beneficial owner

As soon as someone acquires bearer or registered shares and thereby reaches or exceeds the threshold of 25 % of capital or votes in a company (art. 697j CO), he/she is obliged to inform the company about the ultimate beneficial ownership in such shares.

## Regime in force: Sanctions under corporate law for failure to report

If and for so long as a shareholder fails to timely comply with his/her reporting obligations pursuant to art. 697i and/or art. 697j CO or if the report is incorrect, his/her membership rights are suspended (art. 697m para. 1 CO). The property rights, namely the right to a dividend, lapse. If the notification is made at a later time, the property rights arising from that time may be asserted again (art. 697m para. 3 CO).

a) Membership rights

In contrast to property rights, the term membership rights is primarily to be understood as voting rights and related rights (art. 689 et seq. CO). If the notification is omitted, the membership rights are suspended one month after the date of acquisition. They are suspended until the notification is made.

b) Property rights

In particular the rights to dividends and liquidation proceeds are regarded as property rights. There exists some ambiguity with respect to the subscription rights and advance subscription rights, as these include both property and membership rights components. Due to the very drastic consequences, we advocate a restrictive interpretation of this provision, i.e. the term "property rights" should at least in this art. 697m CO be interpreted in such a way so as *not* to include the subscription and advance subscription rights.

The board of directors of the company is obligated to ensure that no shareholders exercise their membership or property rights in violation of the reporting obligation (art. 697m para. 4 CO). Otherwise, he/she risks that a liability lawsuit be filed against him/her. While there exists no duty to investigate that can be derived therefrom, the board of directors should, nevertheless, be aware of the sanctions for violating the reporting obligations.

## Future regime: Criminal sanctions for failure to notify

a) Criminal sanctions for failure to notify

The provisions on reporting obligations came into force in July 2015. In November 2018, the Federal Council decided to implement the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes of July 2016 and certain additional FATF recommendations made in December 2016. According to the FATF, the measures taken regarding the transparency of legal entities and beneficial ownerships are inadequate. In particular, the sanctions under corporate law in case of non-compliance with the reporting obligations and the obligations to keep registers are deemed not effective enough, and accordingly various improvements shall be necessary (cf. Federal Council Message of 21 November 2018).

On this basis, the following criminal sanctions are now proposed:

A fine will be imposed on anyone (i) who *intentionally* violates the obligations to report the beneficial owner of the shares (by omitting the notification or by reporting false information, art. 327 draft Swiss Criminal Code); or (ii) who *intentionally* does not keep the share register or the list of the beneficial owners of the shares in accordance with the law or violates the associated obligations under company law (including by omission) (art. 327a draft Swiss Criminal Code).

Since only the person who *wilfully commits* the offence is liable to prosecution, at least persons who – in mere ignorance of the legal situation - fail to notify the company are not considered to have committed a criminal offence. However, please be aware that the intent also includes the contingent intent (*dolus eventualis*). Thus, those who consider the realisation of an act as being possible and accept this act intentionally (art. 12 para. 2 Swiss Criminal Code).

Which conduct can be qualified as a violation of these provisions by contingent intent? Pursuant to criminal law even a false report may be relevant. Thus, there is already a delicate issue if - in a given case - it is, for example, unclear who among various persons qualifies as the beneficial owner. The legislator has (partially) recognised this problem and proposes a clarification of art. 697j CO in the case of multi-stage participation structures. As, however, many questions regarding the reporting obligations of the beneficial owner and the proper keeping of the share register remain unresolved, further significant definition difficulties arise that will now possibly be subject to the Damocles sword of punitive consequences.

Last but not least, one should also be aware of the risk of abuse (and possible punitive consequences in the event of abuse) in disputes between shareholders or

between the company and its shareholders. Even if, as a result of the aforementioned recommendations, it should prove necessary to make such preparatory actions punishable from a money laundering point of view, the envisaged sanctions appear disproportionate in view of the fact that presumably only a small proportion of shareholders act with this attitude.

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