THE CRUX WITH PAY DISCLOSURE

SUSTAINED DISCONTENT

Compensation disclosure remains a «pièce de résistance» in annual reports. It has a crucial role for investors to form an opinion on how to vote at annual general meetings. However, there still is considerable disagreement between issuers and investors regarding the quality of compensation disclosure. This is reflected in the voting outcomes of annual general meetings, where Swiss-listed issuers receive more against votes on compensation reports than their UK or US peers.

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Discussions on compensation in listed companies belong to the most controversial and fierce issues of corporate governance. Rarely lies the reason for such arguments only in the structure or quantum of compensation paid. Differences in opinion are often triggered by misunderstandings about the compensation system, which sets the main incentives to efficiently execute a specific corporate strategy. Consequently, the workings of a compensation scheme is often taken as an important proxy for good corporate governance by stakeholders.

To avoid misinterpretations and avert negative shareholder reactions in binding votes on compensation at annual general meetings, Swiss-listed companies have continually improved their compensation-related disclosure. Indeed, in last year's SWIPRA Corporate Governance Survey («Survey»), more than 50% of the participating Swiss and international investors confirmed that compensation disclosure quality of Swiss-listed issuers has increased over time.

Yet, despite this improvement, investors seem to remain critical with the compensation disclosure in Switzerland. Particularly, the Survey revealed that investors are looking for additional information on how pay and performance relate, and also that compensation disclosure of issuers in other countries contains more relevant information compared to what is published by Swiss companies.

This appraisal is substantiated by the voting outcomes at annual general meetings of Swiss-listed issuers. The largest 100 companies of the Swiss Performance Index® («SPI100») received a median fraction of shareholders against votes of 12% on their compensation report during the AGM season 2018, substantially above the 9% against votes in the US and the 6% in the UK over the same period and comparable index. For the quartile of companies in each country receiving the highest fraction of against votes, this pattern is even more emphasized with 19% against votes in Switzerland, 11% in the US and 8% in the UK. This disparate voting pattern across countries can also be observed in the voting behavior of some of the largest institutional investors.

Thus, as compensation frameworks overall do not differ significantly between these countries, are often subject to similar trends (more performance-dependent pay, more share-based compensation, longer vesting periods) and quantum is subject to individual (binding) votes in Switzerland, one question remains: why are shareholders in Swiss-listed companies unhappy with the compensation disclosure despite the attested quality improvement?

On the one hand, disclosure regarding compensation is more standardized in the UK and US market, making it easier for investors to read, compare and understand a company's compensation system as well as the paid amounts. It is not clear, however, whether such a standardized format provides investors with the most relevant information about a company's compensation scheme. Particularly in extraordinary situations, which often trigger critical shareholder votes at AGMs, a standardized reporting may provide an incomplete picture.

On the other hand, disclosure requirements, statutorily and market-driven, have increased globally. Consequently, progress has to be considered on a relative basis and quality improvements in disclosure should not be considered as a «nice to have», but are rather as a «must do» to keep up with international market practices and shareholder standards.

For example, in terms of soft law, the UK has just released a new Corporate Governance Code, according to which companies that receive more than 20% against votes need to explain their efforts to respond to shareholder requests. As more than one out of five compensation reports of SPI100 companies received more than 20% against votes in the AGM season 2018, a sizeable number of companies would be affected by such a disclosure provision in Switzerland.

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In addition, the EU shareholder rights directive II substantially increases compensation-related disclosure requirements, demanding issuers, amongst other, to disclose precisely how their compensation-related key performance indicators (KPIs) are derived and how these KPIs developed over the past five years. Both, a clear and traceable definition of the KPIs, particularly for non-GAAP financial measures, and a summary of the KPIs' development over time, are so far only rarely seen in compensation reports of Swiss-listed companies.

International investors adapt to these developments and have started asking for similar information across country borders if they deem specific information useful to better understand compensation systems, including their relation to the overall corporate strategy and the incentives set. Such information request spillovers may not have a regulatory basis in Switzerland, but will have to be taken seriously by issuers in light of the next AGM, considering the overall large international shareholder base of Swiss-listed companies.

Overall, disclosure in compensation-related matters has been improving over the past years, but gradual progress in disclosure quality and scope is important to keep up with a broader market demand for better and more meaningful disclosure, in particular related to compensation.

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