Newsletter

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Outlook Swiss AGM Season 2019: Focus on Boards of Directors and Corporate Social Responsibility

Zurich, January 28, 2018 – For the upcoming Annual General Meeting (AGM) Season, SWIPRA anticipates investor expectations regarding the composition and performance record of boards of directors as well as the related disclosure to increase further. The responsibility of the board of directors towards all of its stakeholders, i.e. the Corporate Social Responsibility (CSR) or socially responsible corporate management, will continue to be a topic of increasing relevance: Investors want to better understand *"how"* a company conducts its business. A challenge SWIPRA has been referring to already in the past.

Specifically, companies and their board members are challenged to increase the comprehensibility of how the CSR framework, corporate strategy as well as risk management and culture of a company are integrated and how this framework influences long-term value. On the other hand, investors have a responsibility to base their investment decisions not merely on standardized CSR criteria, but to recognize socially responsible conduct as an integral part of a company's corporate governance and to reflect this in their engagements and voting behavior. CSR targets will also become increasingly important in compensation systems. They reflect the culture and actions of the company. Board members and shareholders must, therefore, better understand which incentives are set by the compensation system in order to avoid misguided incentives and to not further complicate the already critical pay-for-performance discussion. An increasingly important issue, specifically for Switzerland, will be the traceability of compensation amounts. Specifically, how those approved in previous AGMs reconcile with those actually disbursed to executive management and the board of directors.

Upcoming Events

Board Talk
Event for board members (by invitation)
H1 2019

SWIPRA Analysis AGM Season 2019
Publication
June 2019

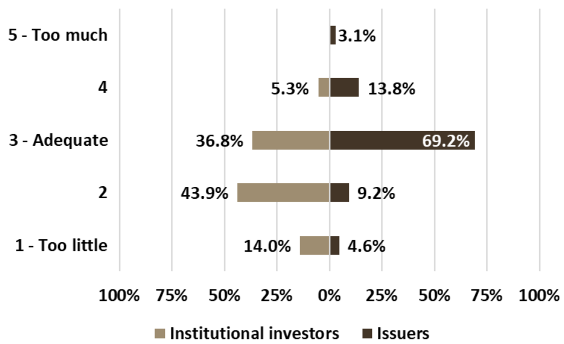
SWIPRA Corporate Governance Survey
Presentation Key Findings
November 2019

Swiss Corporate Governance Dialogue
Event for issuers/investors (by invitation)
Date tba

Board of directors: Focus on composition and performance

Shareholders are looking for a more comprehensive transparency with respect to the board of directors (BoD). There is a growing demand for explanations concerning the composition and continuous development of the board of directors in light of strategic challenges. The SWIPRA Corporate Governance Survey 2018 revealed again that the majority of shareholders considers this information to be insufficient (see Figure 1). Prospective board members are increasingly assessed individually and on the basis of their skills and experiences complementary to the existing body. Shareholders are devoting more attention to this information, ultimately incorporating this

Figure 1: How do you generally assess the disclosure on succession planning for the board of directors? (Source: SWIPRA Survey 2018)



into their voting decisions in a differentiated manner. In addition, the performance of board committees is gradually assessed more critically, particularly in light of crisis situations. The quality of the work of the board of directors and its committees is, therefore, likely to be reflected more directly in the election results of the board of directors' chairperson and committee members, or at least to give rise to critical discussions in the context of engagements (see SWIPRA AGM Analysis 2018). Shareholders will also want to better understand how adequate checks and balances can be ensured in the event of limited or missing independence of the board of directors from executive management or large shareholders. Against this backdrop, SWIPRA expects institutional shareholders to increasingly take activist and thus public measures to protect their interests.

In SWIPRA's view, it is therefore exceedingly important that the disclosure and discussion around these topics go well beyond the minimum regulatory requirements, both with regard to the activities, the processes implemented for independent decision-making as well as the planned composition of the board of directors over time. Such a comprehensive exchange supports important mutual understanding and trust between shareholders and the board of directors. SWIPRA's analyses over the past years show: The regular exchange between boards of directors and their stakeholders generally result in more positive AGM outcomes (see SWIPRA Corporate Governance Survey 2017). These companies will also be able to communicate better and faster with their shareholders in crisis situations.

Engagement Priorities

Blackrock

Fidelity

Legal & General

Norges Bank Investment Management

State Street Global Advisors

UBS Global Asset Management

Vanguard

Corporate Social Responsibility: Increasing requirements for companies and investors

The board of directors is increasingly judged by whether it takes decisions not only in the interest of shareholders, but considers a wider range of stakeholder interests, rising the pressure on companies to design and manage an integrated Corporate Social Responsibility framework. At the same time, requirements on institutional asset managers' general duty of care put forward by asset owners, mainly pension funds and insurance companies, as well as the legislator are increasing. Accordingly, many institutional asset managers are driving the integration of CSR criteria into their investment processes and are developing their own guidelines. Typically, these are based on a wide range of different CSR data and "ESG"-ratings in order to assess and potentially exclude single companies or sectors from the investment universe.

Proxy Advisors 2019

ISS

Guidelines Europe 2019

Glass Lewis

Guidelines Switzerland 2019

Ethos

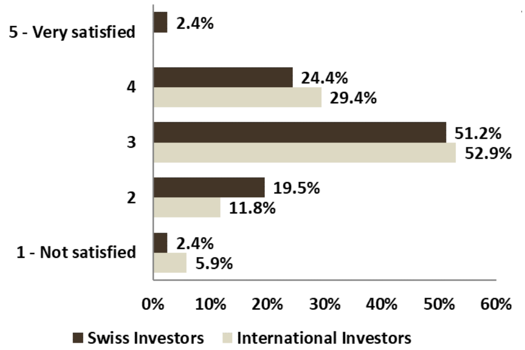
Guidelines Switzerland 2019

SWIPRA considers this development rather critically. In SWIPRA's view, it is not sufficient to assess CSR according to pre-defined individual measures such as the achievement of a gender quota, a CO_2 balance or the fulfilment of certain ratings without effectively establishing a relationship to the long-term value of the company and its contribution to social welfare. SWIPRA is of the opinion that this overarching link is still not fully understood, resulting in reasoning that is often based on considerations of insufficient single criteria. CSR covers comprehensive processes defining *"how"* a company conducts its business activities, concerning both, strategic opportunities as well as strategic risks. Thus, an integrated CSR framework is very relevant for generating sustainable and comprehensible corporate profits.

Excluding certain companies or sectors from an investment universe will not noticeably improve CSR, but will often reduce the return on the investors' portfolios according to various research studies. Converseley, sociopolitically and financially, CSR remains relevant for both, excluded and invested companies. Investors should, therefore, actively exchange and share their views with the board of directors of "their" companies and give weight to their views by voting at AGMs. SWIPRA is of the opinion that for engagements to be successful, companies should, amongst other, transparently explain their CSR processes and responsibilities anchored in their governance and incentive framework. Likewise, investors should be prepared to assess the information provided by their portfolio companies carefully and with a focus on the individual company.

The discussion about CSR and its transparent disclosure is gaining particular importance in Switzerland due to the responsible business initiative (see box on the right). Swiss companies should, therefore, increasingly demonstrate not only to their investors, but also to the broader public, how they implement CSR in their business and explain its strategic relevance. According to the most recent SWIPRA corporate governance survey, the majority of investors still considers the related disclosure as inadequate and, consequently, does not understand the strategic relevance sufficiently (see Figure 2).

Figure 2: How satisfied are you with the meaningfulness of the disclosure of Swiss-listed companies regarding



Compensation: Non-financial factors, pay-for-performance and traceability of amounts

As a result, CSR measures are becoming an increasingly important factor in the structure of incentive systems. The achievement of strategic CSR targets should not only be reflected indirectly in the compensation of management through a long-term increase in the market value of the company. This is a result of the SWIPRA Survey 2018 (see Figure 3). Instead, direct incentives should encourage relevant actions in the short term. Consequently, SWIPRA expects, in addition to a higher weighting, a

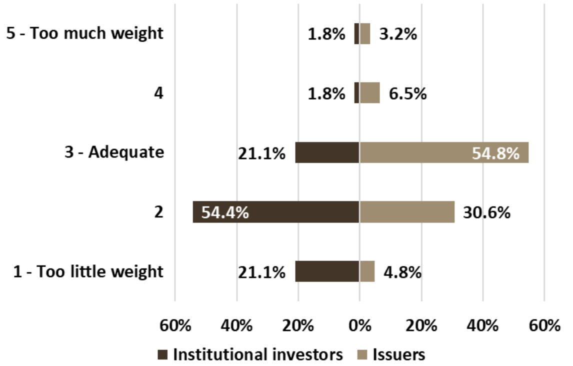
Important regulatory and legal developments in Switzerland

The **responsible business initiative** demands legally enforceable claims against Swiss-listed companies and their boards of directors, with the requirement that Swiss minimum standards regarding CSR must be adhered to by the companies' entire global value chain. A fact-based and objective discourse on the severe effects of this emotional initiative is indispensable. To bridge the currently differing perceptions, companies are called upon to show more proactively and transparently to what extent they are already addressing these issues and how they are anchoring CSR in their governance, strategy and corporate objectives. This will help to better explain to the public the progress and standards of Swiss companies in this area, also compared to international standards.

The **revision of company law** was again delayed with the decision of the Council of States to refer the matter back to its legal commission at the end of 2018. Previously, in December 2018, the commission had put forward, amongst other, proposals for integrating the Ordinance against Excessive Compensation ("OaEC") into the revision – some proposals which had already been dealt with in the earlier political process and that would largely restrict shareholders' rights. SWIPRA surveys of recent years show that most of the proposals made to implement the OaEC in the company law are clearly not in the interest of and thus not desired by shareholders (current SWIPRA article on the revision of company law, in German).

more thorough discussion on how these goals should be incorporated into the incentive structures. In particular, this is about improving the overall understanding about which incentives are *effectively* set and how they are aligned with the strategic goals.

Figure 3: In your opinion, do (non-financial) corporate social responsibility targets receive sufficient weight in the determination of variable remuneration? (SWIPRA Survey 2018)



The increasing proportion of shareholder votes against remuneration reports of Swiss-listed companies in the past is also due to the fact that investors still consider the disclosure of the relationship between variable remuneration and performance ("pay-for-performance") to be insufficient. As a result, proxy advisors and investors often use their own models and assumptions in their analyses. However, their results often differ from those of the companies. From SWIPRA's point of view, it is therefore important for companies to make clear and transparently disclose the link between their strategy, the achieved performance and the resulting remuneration. Discretionary decisions are perfectly acceptable, provided they are explained clearly and pay-for-performance remains comprehensible.

With the annual binding votes on the maximum remuneration amount, shareholders of Swiss listed companies have a unique tool at their disposal to control the levels of remuneration of management and the board of directors. In principle, this system offers shareholders of Swiss-listed companies advantages over shareholders of companies listed in the EU or the USA in terms of a more direct and transparent supervision of maximum remuneration. However, it is often difficult to track how the maximum amounts voted on compare with the actual amounts disbursed. SWIPRA expects that companies (and auditors) will be increasingly required to improve the traceability of how the amounts voted on relate with amounts used in their remuneration report and to clarify the link to the amounts proposed at the forthcoming AGM.

Select SWIPRA Publications

Article Company Law Revision (Dec 18)

SWIPRA Corporate Governance Survey 2018 (Nov 18)

SWIPRA AGM Analysis 2019 (Jun 18)

About SWIPRA Services

We support companies and boards of directors in the design and disclosure of their corporate governance and corporate social responsibility - frameworks and institutional investors in the responsible exercise of their shareholder rights. Our analyses and advisory services are based on scientific findings and a market-oriented perspective supported by our many years of experience. SWIPRA promotes a constructive dialogue between investors and public companies with the aim of generating long-term, sustainable value. www.swipra.ch

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