Newsletter 02/2023

SWIPRA Outlook AGM Season 2023

AGMs 2023 and beyond – Ready for your stakeholders' expectations?

Zurich, February, 2023 – The first post-Corona physical AGM season will require Boards to take important decisions with respect to shareholder interaction, compensation arrangements and stakeholder dialogue.

The amended Swiss corporate law will require approvals of updated Articles of Association, and while many of the proposed changes just reflect regulatory necessities, proposals concerning virtual AGMs, or the capital band (replacing the authorized capital) leave companies room for choice. These items thus require transparent communication and explanations of the decision taken to avoid misconceptions at AGM votes.

Compensation will remain in the spotlight. The economic impacts from the pandemic and the geopolitical turmoil leave Boards with the obligation to ensure that the income gap between management and employees does not grow any further. Boards should use this opportunity to also reconsider whether existing compensation structures still serve the purpose. Not least because companies so far do not explain well how *long-term* strategically relevant targets as well as their key stakeholders' expectations are reflected in their pay policies. Companies should also pay attention to the revised Swiss Code of Best Practice in Corporate Governance ("Code") that was recently published. With its integrated view on sustainability, the Code asks Boards to take shareholder and more general stakeholder views into consideration when taking strategic decisions. Aligned with international market developments of the recent past, the Code encourages Boards to engage regularly with their key share- and stakeholders. Together with the new level of transparency needed in view of the upcoming shareholder vote on the non-financial report in 2024, Boards are required to establish a solid stakeholder interaction that goes beyond a "classical" financial roadshow.

Next Events

Corporate Governance Excellence 2023
Event by FuW, Cooperation Partner SWIPRA
27 June 2023

SWIPRA Swiss AGM 2023 Review
Results Presentation
June 2023

The amended Swiss corporate law – key innovations

- Introduction of a **capital band** bears pitfalls that need to be carefully addressed with shareholders
- A company's view on **future forms of AGMs** and respective shareholder rights needs to be clarified
- Necessity for dialogue between shareholders and companies on what information is key to take informed **votes on sustainability reports** by 2024

Companies may need to implement a capital band at their 2023 AGM if they want to replace an expiring authorized capital. Due to missing experience with this kind of capital instrument, this comes with pitfalls. It requires a careful review beyond just the regular legal alignment of how to structure the band. Shareholders are expected to have a particular focus on the dilution potential and duration of the band. The dynamic nature of the band may, however, not always be easy to reconcile with the limitations set by investors' voting policies.

A lot of discussion was held in the wake of the upcoming AGM season on the future formats of annual shareholder meetings. Proxy advisors and shareholders continue to view virtual AGMs rather critically, fearing that the virtual format may diminish their rights, despite the law clearly stipulating the contrary, namely that shareholders will have the same rights, independent of the AGM format. There seems to be a lack of confidence that equal rights across formats will eventually also be enforced. To counter this shareholder skepticism, companies planning to include the possibility of a virtual AGM in their Articles should be clear in their explanations regarding their rationale for such formats and explain how shareholder rights will be taken into account in each of the possible formats. Referring to the law only will not do the job.

2023 is a transition year for the non-financial reporting of listed Swiss companies. Many are in the process of aligning the timing of the release of their sustainability-related data with their financial data to create the basis for the 2024 shareholder vote on the sustainability report. It is expected that some larger companies will test the waters by including a (voluntary) vote on the sustainability report already at their 2023 AGM.

With the non-financial report becoming a mandatory item on the AGM agenda in 2024, its relevance increases from the glossy narrative to a strategic communications tool. This vote will function as a tool for shareholders to signal potential criticism on a company's sustainability efforts. But Boards should expect shareholders to be quicker and more determined in holding Board members accountable than this was the case for compensation-related topics when the say-on-pay was introduced in 2013.

Glass Lewis Updates

Glass Lewis (Switzerland)

Glass Lewis (Continental Europe)

Glass Lewis (ESG Initiatives)

Compensation system outcomes increasingly challenged – What has changed?

- With the expected better and more quantitative disclosure on E & S-related data, companies will face pressure to update or include tangible ESG-linked incentives in their compensation schemes.
- The vesting of the first long-term incentives (LTIs) granted during the period of Corona-implied depressed share prices may trigger a discussion about the future of LTI instruments
- Boards need to pay attention to the pay ratio, the ratio between pay to management and pay to the average employee, as part of their broader societal responsibility, especially in times of high inflation rates in various countries.

Swiss Proxy Advisor Updates

Ethos

Inrate

In 2022, we have observed a significant increase of companies including **sustainability metrics** in their compensation systems (c.f. SWIPRA 2022 AGM Analysis). Oftentimes these metrics were not clearly defined, and shareholders do not understand why the set sustainability indicator is material for the company. Further, investors often consider the weight of these KPIs in compensation systems to be too low (c.f. SWIPRA Survey 2022). These findings are the result of companies being rushed to include such a KPI without having clear visibility about their strategic relevance (therefore the small weights). Realizing this, shareholders have also become reluctant to ask for ESG KPI no matter what. With the sustainability topics receiving more strategic visibility, not least because of the Board's responsibility for the non-financial reports going forward, we expect companies to have a more solid basis to define, measure and include sustainability KPIs in their variable compensation and allocate them more weight.

The volatility of share prices triggered first by Corona and then by geopolitical turmoil has raised questions regarding the suitability of today's compensation systems. **Long-term plans** have come under scrutiny, as

Swiss Regulatory Developments

[Swiss Code of Best Practice in Corporate Governance]

[Federal Council TCFD Ordinance]

share grants allocated at times of depressed share prices result in a higher number of shares granted and elevated levels of effective payout at vesting. This is not necessarily due to superior performance by the company, but due to a general price recovery of the overall market. Various institutional shareholders and proxy advisors have raised concerns regarding this problem and expect Boards to use their discretion to downward adjust long-term plan payouts in case of significant impacts by share price movements driven by external factors. Also, Boards are asked by investors and proxy advisors to use their discretion to better align compensation turnouts with stakeholder experiences, indicating that compensation systems may need reconsideration. For LTIs, this could involve reviewing vesting levels above 100% ("vesting leverage").

The **level of compensation** has rarely been discussed, not least because it is not straightforward to define and understand an objective maximum amount that is also comparable between companies. Since companies are required to increasingly consider stakeholder views, the compensation benchmarks inside a company, that is the relative pay levels and their developments within a company receive more attention. Respective requirements are stipulated by the new Swiss Code, the UK's investment association's principles of remuneration, or the updated proxy guidelines of Glass Lewis. We expect that this internal pay ratio, in particular its year over year development within a company, will receive more attention in the upcoming AGM seasons due to the negative impact of the current economic and geopolitical developments on the freely available private incomes. Although Swiss companies are required to report such a ratio, Boards should be aware of this in the context of the discussion regarding good citizenship and address this in their stakeholder dialogues.

Realignment needed? New Swiss Code of Best Practice in Corporate Governance ("Code")

- The updated Code remains principle driven – it should be seen as a basis regarding good corporate governance in Switzerland and the general needs of stakeholders. Compliance with the Swiss Code will be expected, but not be sufficient, depending on the specific stakeholder requirements and the individual requirements of a company.
- Boards are asked to reach out actively to their main stakeholders and have a regular dialogue with their shareholders, following elevated levels of AGAINST votes
- The Code follows an integrated ESG approach asking Boards to reflect stakeholder interests in their corporate decision and set sustainable long-term goals

Nine years since its last revision, an updated version of the Swiss Code was released on Feb 6, 2023. Consistent with previous versions, the Code remains principle driven, providing high-level concepts of good governance rather than narrow recommendations for action.

Accordingly, following the Code implies agreement on these overarching concepts of good governance. Companies are required to take individual decisions on how to put the concepts of the Code into practice, how to address its individual needs while reflecting its key

ISS Updates 2023

[ISS (EMEA Update)]

[ISS Continental Europe]

[ISS Sustainability International]

stakeholder expectations and explain the rationale behind these decisions. Companies should be aware that expectations may go beyond the scope of the Code, in particular with respect to a Board's independence assessments as well as the Board's organization and composition.

The new Code emphasizes the relevance of the dialogue between the Board and the company's stakeholders. Interaction with shareholders is no longer considered a "nice to have," but an integral part of good corporate governance. Accordingly, Boards are expected to take shareholder views into account when taking decisions and actively seek their views in case of elevated levels of AGAINST votes at the AGM. The Code also expects the Board to engage with a company's most important stakeholders to assess their expectations and views. For Boards, it is important to be well prepared for this dialogue, internally aligned with the regular messaging and externally ready to speak about governance and strategy topics that go beyond the regular financial road show (c.f. SWIPRA Survey 2022).

The Code takes a highly integrated view on sustainability. Rather than focusing on individual environmental or social topics, it places sustainability directly in the governance corner with the Board of directors. The Board is expected to set out a long-term strategy for the company that is sustainable. In developing this strategy and taking decisions, the Board is asked to consider not only the interests of shareholders, but also other stakeholders such as employees, suppliers, clients, society, and the environment. Accordingly, Boards must be aware that environmental and social topics can no longer be considered separately from a company's general business but need to be integrated in the company's overall strategy, and that this and the related communication is the Board's own responsibility.

Contact

Barbara A. Heller, Managing Partner, T: +41 (0) 55 242 60 00, E: barbara.heller@swipra.ch