SWIPRA CORPORATE GOVERNANCE SERVICES & DIALOGUE

Newsletter 11/2020

Corporate Governance Survey 2020

SWIPRA survey reveals new priorities in corporate governance

The 8th SWIPRA Corporate Governance Survey shows important shifts of priorities regarding corporate governance, sustainability and corporate social responsibility (CSR) among international market participants. The board of directors and its committees are expected to show more leadership and participate more actively in shareholder engagements and a "private-to-public" dialogue with stakeholders concerning CSR. Investors consider compensation systems not to be sufficiently aligned with social and environmental priorities and judge adjustments to bonus payments due to Covid-19 highly controversial. Investors often try to standardize their assessment of CSR factors by means of environmental and sustainability ratings, although the credibility of such ratings remains rather modest in the market, despite the high level of attention and focus on a few providers. Instead, shareholders should increasingly review CSR information as disclosed by companies and seek a dialogue with them on these topics.

Further, the majority of institutional shareholders is prepared to support shareholder resolutions at AGMs, that will become easier in Switzerland following the revision of the stock corporate law, and would like to see a more extensive disclosure by companies on due diligence along their global supply chain. This goes along with a strong desire for the possibility to vote on a company's sustainability report at the AGM. In addition, there is a clear preference for hybrid AGMs in the market. The survey also reveals interesting opinions on further regulatory issues and shareholder rights.

Next Events

4. Swiss Corporate Governance Dialog
For companies and investors (invitation only)
Postponed to Q1 2021

Institutional Investor Survey 2021
Morrow Sodali Event, Q1 2021

SWIPRA Analysis AGM Season 2021
Publication, June 2021

Covid-19 - Accelerator, not trigger

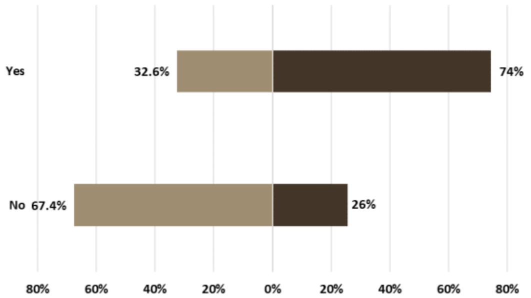
According to the 2020 SWIPRA survey, real effects of Covid-19 on corporate strategies are rather limited. The majority of companies (60%) see no or only little influence. However, 51% of the companies believe that liquidity and capital management have become more important, while 27% say that Covid-19 accelerated the integration of CSR into corporate strategy.

Covid-19 also forced a critical assessment of the existing AGM format. 74% of the participating shareholders would welcome hybrid AGMs allowing for both, physical as well as virtual participation/voting in the future. Only 11% prefer the so far common physical AGMs. Among companies, the opinions regarding the hybrid (38%) and physical (35%) options are balanced. Only a minority (shareholders 11%, companies 18%) prefer fully virtual AGMs. This confirms the importance of the AGM as an important tool for corporate communications.

Board of directors - More leadership required

The current events revealed once again the strategic importance of capital allocation and structure, compensation, corporate culture, stakeholder management, and CSR overall. A majority of the shareholders (75%) see the responsibility for integrating CSR and corporate strategy with the Board of Directors; which is the case in only 49% of the participating companies, while management takes on this task in 28% of the companies. The question of who is taking the lead in this area is well understood by only 25% of shareholders, and as many as 67% said that the boards of directors of Swiss companies have been showing only limited leadership in this regard (see Figure 1).

Figure 1: Are boards of directors in Switzerland taking sufficient leadership in integrating a company's strategy with corporate social responsibility as well as incentives and capital allocation?



As a result, 61% of shareholders will give greater weight to the topic of "leadership" of the board of directors in their engagements with companies in the run-up to the 2021 AGM season. It is required that the boards will become more visible and explain themselves in strategically important decisions.

A majority of shareholders (54%) also considers the board to have a duty of care with regard to the company's global value chain. In the SWIPRA Survey 2017, shareholders already indicated that, especially in developing countries, the board of the parent company (40%) rather than local management (7%) should be responsible for measures ensuring compliance with minimum CSR standards. For 69% of shareholders, relevant information for the assessment of the duty of care along the global supply chain is (i) a description of the preventive measures taken and (ii) a report or at least a comprehensive disclosure on compliance with these measures (59%). However, only 38% of shareholders believe that CSR reporting should be externally audited.

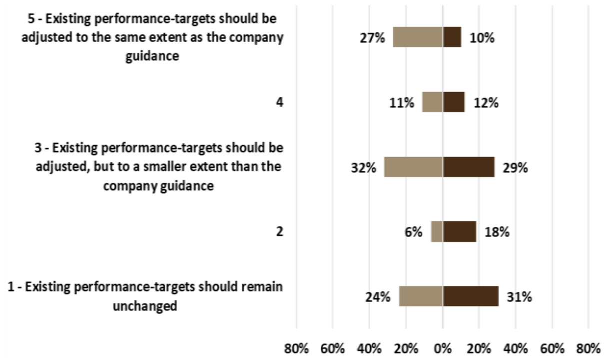
Socially responsible actions are given a much higher priority in the company's engagements, with 67% of shareholders observing an increased need for discussion. The basis for this dialogue should be company-specific, non-financial factors that are considered "material" by the company. Yet, only 42% of the companies surveyed have already conducted such a materiality analysis for CSR factors. Moreover, 47% of the companies only participate in a dialogue if requested to do so by shareholders. But board leadership also means a more active search for this dialogue. A study by Morrow Sodali on the European market shows that institutional shareholders tended to vote less critical in board elections in 2020 due to the Covid-19 situation, but have clear expectations for 2021 in terms of social risks and strategy. These concerns must be addressed actively in engagements. Proxy advisors have also already announced that they will analyze the behavior of companies in the area of CSR more critically and ultimately incorporate such assessments more specifically and directly in their recommendations for board elections.

Compensation - Systems are not up to date

Going into 2021, the board and its compensation committee are faced with challenging decisions. On the one hand, they have to decide to what extent the Covid-19 driven economic developments will impact the performance assessment for the 2020 bonuses. On the other hand, they need to improve their understanding of corporate culture and incentive structures from a strategic perspective (financial and non-financial) to better reflect new priorities and behavioral factors in existing compensation systems.

There is clear disagreement about the assessment of performance for the variable compensation of 2020: 44% of non-Swiss shareholders believe that the original targets should be maintained, while only 17% of Swiss shareholders share this view. 31% of the companies stated that no extraordinary adjustments will be made, 27%

Figure 2: In your opinion, how should existing performance-targets for variable compensation elements be adjusted in case a company makes an extraordinary guidance adjustment?



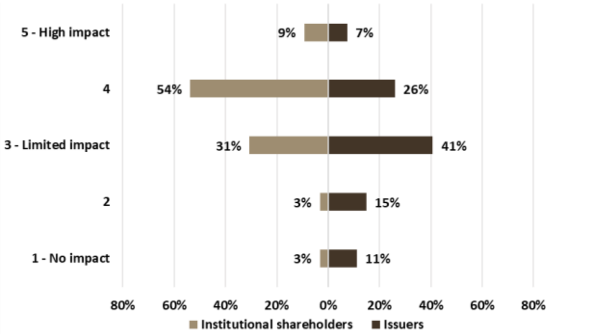
expect smaller adjustments (see Figure 2). A timely and transparent exchange between the board, in particular the compensation committee, and the shareholders is important in this context, as 43% of the shareholders still consider the quality of disclosure of "pay for performance" of Swiss companies to be below average. For 2021, proxy advisors have announced that they will critically review any extraordinary adjustments in the compensation targets, especially if justifications are missing.

When redesigning compensation systems, the new priorities must be taken into account: for 76% (non-Swiss) and 66% of shareholders (Swiss) respectively, environmental goals such as CO_2 or social goals such as equal pay do not receive enough weight. 43% said that financial targets still received too much weight in the existing compensation systems. Shareholders' AGM rights regarding compensation were also judged controversial. While 68% of companies (and only 33% of shareholders) have come to terms with the current system, 48% of shareholders would like to see an extension of their rights.

CSR Ratings - Large influence, little trust
Due to the increased focus of institutional investors on non-financial aspects, the weight of sustainability ratings is increasing. 74% of institutional shareholders rely on such ratings, the most preferred ones being provided by MSCI, ISS, and Sustainalytics. Around 53% of asset managers use such ratings in their company valuation models, 27% use them directly for investment decisions such as defining exclusion criteria. For pension funds, ratings serve as a basis for investment decisions in 67% of cases. 73% of companies consider ratings, whereby their choice is mainly driven by external factors such as best practice (33%) considerations or the preference of their largest shareholders (33%).

Shareholders are of the opinion that CSR ratings have a (major) influence on strategy (34%) as well as disclosure and engagement issues of companies (63%) (see Figure 3). When choosing a rating provider, the most important criterion for institutional shareholders is the amount of information provided (36%). Only 9% stated that the provider was chosen based on data quality. However, the ratings are also viewed quite critically by shareholders. Only 22% of institutional shareholders consider these ratings to be truly reliable for evaluating a company's CSR.

Figure 3: Do you expect an impact of ESG ratings (for example Sustainalytics' ESG Rating, MSCI ESG Rating or ISS QualityScore) on your company's business strategy?



The trustworthiness of these ratings was already critically questioned in the 2019 SWIPRA survey: at the time, only 24% of the companies saw their CSR efforts adequately reflected in the ratings. Potential for improvement can be achieved through a more comprehensive dialogue, but also with the willingness of stakeholders to get a better understanding, as only 44% of the companies believe that institutional shareholders make sufficient use of the CSR information they provide. At the same time, 61% of shareholders would like to require companies to report under an international CSR disclosure standard.

Understanding the relevance of non-financial factors will play an even greater role in the future. As a result, the complexity and demands placed on companies and institutional shareholders will increase disproportionately. The temptation to take shortcuts in the form of "one size fits all" standardizations may seem attractive in the short term but are unlikely to succeed in the long term.

Further results - Regulation & Audit
The 2020 SWIPRA survey also addressed current developments in the regulation or the work of the external auditor. Putting shareholder proposals on the AGM ballot will become easier going forward as a result of the revised Swiss corporate law. Facilitating shareholder proposals was a very

important shareholder concern according to the 2018 SWIPRA Survey. Accordingly, 69% of the non-Swiss and 38% of the Swiss shareholders stated that they would be willing to support such shareholder resolutions. Also, 56% of the shareholders would like to see regular, non-binding AGM votes on sustainability (CSR) reports and 75% would like to see a mandatory disclosure for companies and institutional investors on contributions to political parties, stakeholders, and lobby groups.

The relevance of the Swiss Code of Best Practice in Corporate Governance shows how controversial the topic of voluntary disclosure is. 39% of investors find the Code helpful, but insufficient in terms of disclosure requirements, while 89% of companies consider the Swiss Code helpful and sufficient.

Opinions differ on the independence of the external auditor. Only 13% of the foreign and 54% of all participating shareholders consider the external auditors to be sufficiently independent, compared to 95% of the companies. Concerning the tasks of the external auditor, the expectation gap appears to be widening again. A majority of companies (66%) and shareholders (76%) consider the detection of fraud to be an external auditor's task, and ¾ of all participants would like the auditors to check the proper use of state-guaranteed Covid-19 loans.

About the study

In collaboration with a team of researchers from the Institute of Banking and Finance at the University of Zurich, all companies listed on the Swiss Performance Index SPI® as well as institutional investors from Switzerland and abroad were invited to participate in the 8th SWIPRA survey on corporate governance in Switzerland. During the survey period (August/ September 2020), 73 Swiss companies listed on the SIX Swiss Exchange, representing about 77.2% of the market capitalization of the Swiss Performance Index, and 76 institutional asset managers and asset owners from Switzerland and abroad participated. The participating investors, around 40% of them based abroad, represent at least 27.2% of the equity investments managed worldwide and hold substantial stakes in Swiss companies.

Other SWIPRA Publications

Governance Developments in Switzerland

SWIPRA AGM Analysis 2020

Corporate Governance after Covid-19

MorrowSodali European AGM Season Review

About SWIPRA Services

SWIPRA Services provides **corporate governance services** for companies and their boards of directors as well as for institutional investors in responsible investing. We work with our clients with the goal of long term value-creation, based on principles of value-based management and empirically relevant criteria. SWIPRA Services is an exclusive partner of **Morrow Sodali** in Switzerland. **www.swipra.ch/**

SWIPRA Services is working with a high-profile think tank to further develop corporate governance in Switzerland: **Members**

Contact

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