

Corporate Social Responsibility – New Relevance for the Board of Directors?

SWIPRA Corporate Governance Survey 2019

Zurich, November 5, 2019




SWIPRA Corporate Governance Survey 2019

- 7th SWIPRA Corporate Governance Survey
 - Scientifically-founded market analysis of investors' and corporate issuers' views over 7 years
 - Survey covers developments in governance in the Swiss market and includes views on current topics
 - In cooperation with researchers at the DBF (UZH)
-



SWIPRA Corporate Governance Survey

Key findings of the past

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- 2013 Status quo and perspectives of corporate governance in Switzerland
 - 2014 After the Ordinance against Excessive Compensation
 - 2015 Market discipline and regulation
 - 2016 Corporate governance between globalization, shareholder activism and proxy advisors
 - 2017 Governance Activism – The increasing importance of corporate governance in fund managers' decision making
 - 2018 Who decides, who takes responsibility?
 - 2019 Corporate Social Responsibility: New relevance for the board?
-



SWIPRA Corporate Governance Survey

Survey relevance over time *



2015	77.9% of SPI® market cap and 18.8% of global equity AuM
2016	81.3% of SPI® market cap and 21.2% of global equity AuM
2017	79.3% of SPI® market cap and 20.8% of global equity AuM
2018	77% of SPI® market cap and 26% of global equity AuM
2019	78% of SPI® market cap and 30% of global equity AuM representing approx. EUR 17.8tn equity assets Total of 153 participants: 78 issuers, 46 asset und fund managers (approx. 50% non-Swiss), 29 pensions funds

* From 2015 on including international investors



SWIPRA Corporate Governance Survey 2019

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Plan for this presentation

- **Key results - SWIPRA Survey 2019**
 - CSR – Mind the gap
 - Engagements – Bridge the gap
 - Corporate Governance and CSR – A story of integration
 - Board of Directors – Responsibility and independent decisions
 - Additional topics
 - Compensation
 - AGM voting
 - Anchor shareholder companies
 - Audit
 - Further scope
-



Key results (I/III)

➤ **Corporate social responsibility – Mind the gap**

- Issuers and investors are missing a basic mutual understanding of how corporate social responsibility impacts each others' processes and decisions → impact on disclosure!
- For investors, it is not clear how companies integrate CSR into their corporate strategy
- For companies, it is not clear how CSR criteria influence the investment and voting behavior of their shareholders

➤ **Engagements – Bridge the gap**

- Key reason for institutional investors to conduct engagements is to better understand the individual situation of their portfolio companies
 - Engagements continue to be dominated by large, non-Swiss and generally passive shareholders, who are invested for the long-term and often intend to shape their investee companies' governance frameworks through engagements
 - Swiss shareholders rather invest based on exclusion strategies, with a lower emphasis on engagements, which are considered too costly in light of the expected benefits for their business
-



Key results (II/III)

➤ **Corporate governance and CSR – A story of integration**

- CSR is not an isolated engagement topic, but plays an important role in driving discussions on key governance topics such as strategy, compensation, and board of directors. It should, therefore, be reflected correspondingly in corporate reporting and disclosure
- Investors' performance assessments of the board of directors rely increasingly on how a company structures its CSR policies and how it deals with actual CSR issues
- CSR performance indicators in short-term bonus plans are seen important for long-term sustainability, even if this results in a higher bonus allocation discretion of the board

➤ **Compensation – Pay for what?**

- Investors increasingly see strategic opportunities arising from CSR-efforts and believe their realization should be positively incentivized in the compensation framework
 - Satisfaction level of shareholders with pay for performance disclosure remains (very) low
 - Inclusion of non-financial KPIs related to CSR in the compensation framework will require a higher quality and more meaningful disclosure to keep pay for performance traceable
-



Key results (III/III)

➤ **Board of directors – Criticism about responsibility and independence**

- Shareholders continue to criticize boards of Swiss companies for not taking sufficient responsibility in dealing with CSR issues
- Structure of Swiss boards seen as insufficient to promote independent decision making
- High information asymmetry within the board seen as limiting the contribution of directors

➤ **AGM votes – Privilege or burden?**

- Cost of AGM-voting outweighs benefits according to Swiss, but not to non-Swiss investors
- Issuers consider institutional investors to carry out AGM voting diligently

➤ **Anchor shareholders – Need for explanation**

- Shareholders consider the governance framework and related disclosure of companies with an anchor-shareholder inferior to those of widely-held companies
 - Shareholders have less access to the boards of anchor-shareholder companies
 - Engagements are supported by geographical proximity, with Swiss institutional investors getting better board access to small and/or anchor shareholder companies
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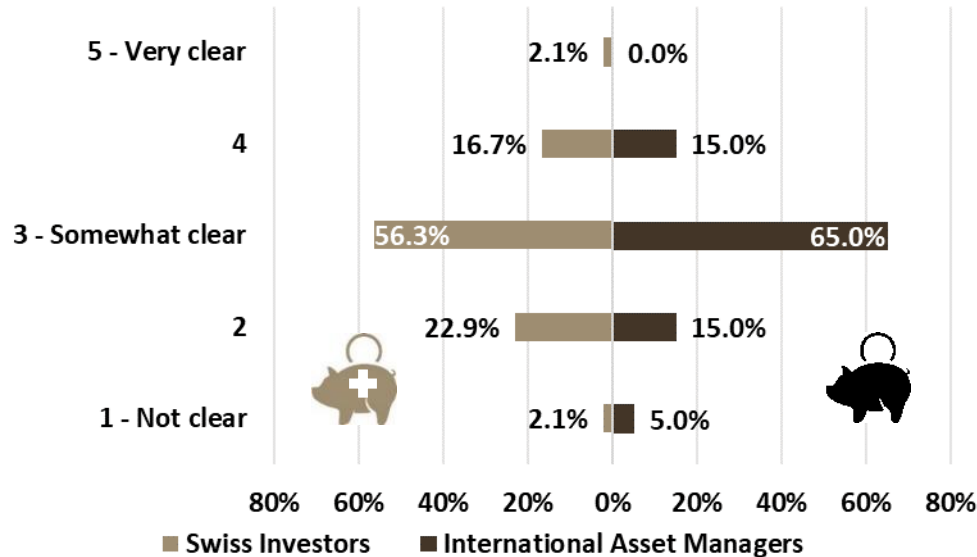


CSR – Mind the Gap (I/IV)

Investors' difficulties in understanding CSR in strategy...

Reflection of CSR in corporate strategy

Survey 2019



- Less than 20% of the institutional shareholders understand clearly how companies reflect CSR in their strategy

	Pension funds	CH asset managers	Int. asset managers
5 - Very clear	0.0%	4.5%	0.0%
4	19.2%	13.6%	15.0%
3 - Somewhat clear	57.7%	54.5%	65.0%
2	23.1%	22.7%	15.0%
1 - Not clear	0.0%	4.5%	5.0%

Question: Is it clear how Swiss companies incorporate CSR into their corporate strategy (including corporate governance structure and compensation incentives)?



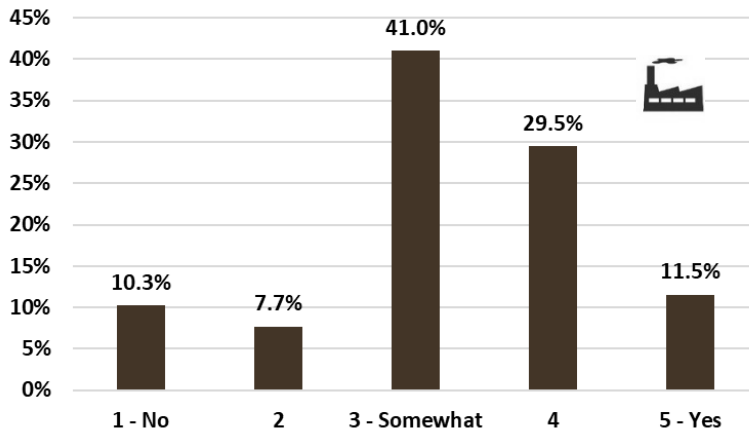
CSR – Mind the Gap (II/IV)

and issuers' struggles in understanding CSR's impact on investors decisions.

Do issuers understand how corporate governance and CSR impact...

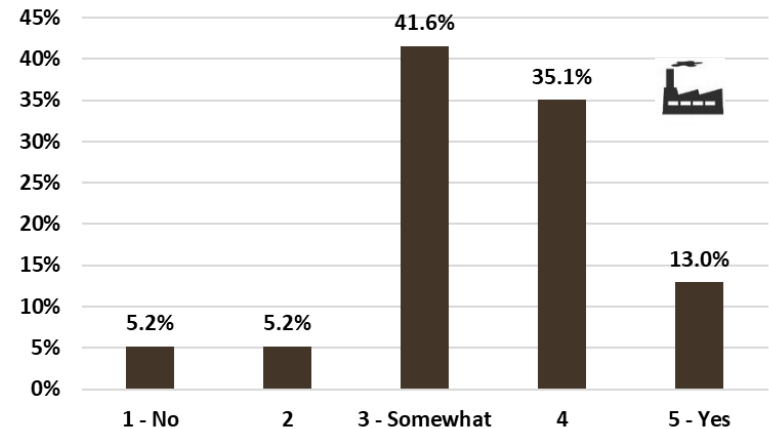
...investors' investment decisions

Survey 2019; issuers only



... investors' AGM voting decisions

Survey 2019; issuers only



-
- Less than half of the companies really understand how investors incorporate CSR information in their investment and voting decisions
-

Question: [left] Do you generally understand how institutional shareholders incorporate information on corporate governance and CSR in their investment decisions. [right] Do you generally understand how institutional shareholders incorporate information on corporate governance and CSR in their AGM voting decisions?

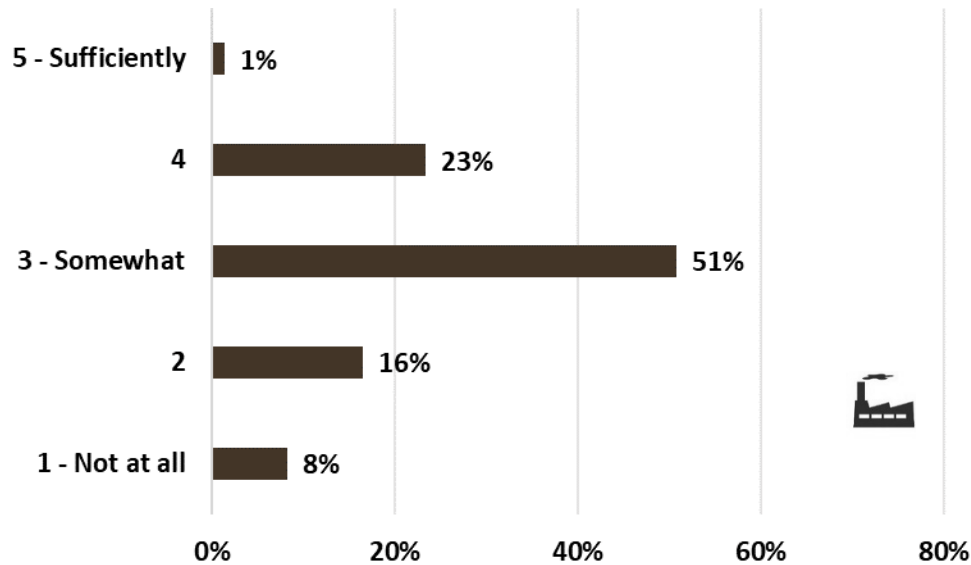


CSR – Mind the Gap (III/IV)

ESG-ratings

CSR-effort and its reflection in ESG-ratings

Survey 2019; issuers only



- Less than 24% of the issuers consider their CSR-efforts to be reflected sufficiently in their ESG-ratings
- These ratings are an increasingly important source for investment allocation
- Important to have a mutual understanding of what these ratings truly measure

Question: In your view, to what extent are "ESG-ratings" reflecting the actual CSR-effort of your company?



CSR – Mind the Gap (IV/IV)

Implications

A mutual understanding of how CSR impacts a company's strategy is important (i) for investors' allocation of funds and voting behavior, and (ii) for companies in their external communication.



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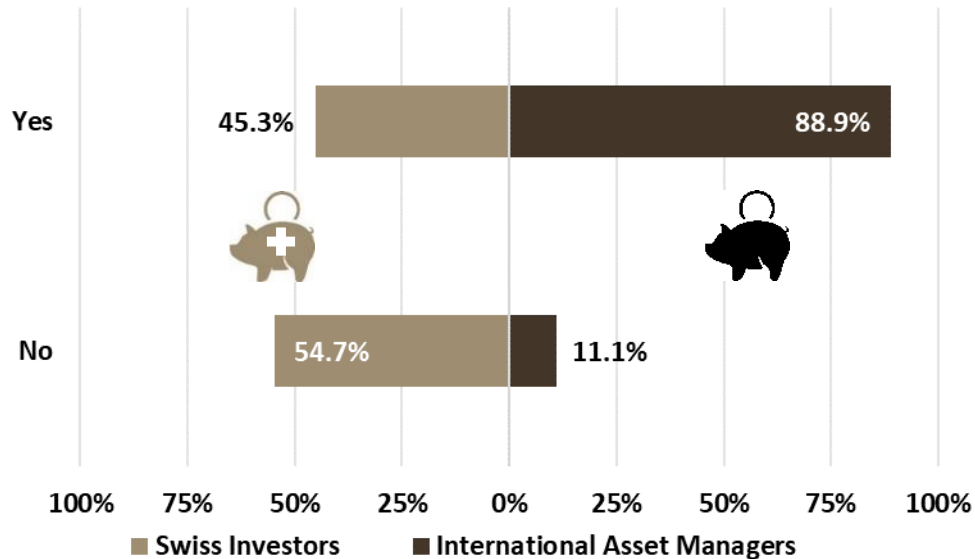


Engagements – Bridge the Gap (I/IV)

Participation in engagements

Are engagements with portfolio companies conducted?

Survey 2019



- Engagements are crucial to bridge the gap in mutual understanding
- This dialogue is mainly driven by non-Swiss institutional investors
- These investors generally hold large stakes in Swiss companies and are often passively invested

	Pension funds	CH asset managers	Int. asset managers
Yes	27.6%	66.7%	88.9%
No	72.4%	33.3%	11.1%

Question: Do you conduct corporate governance engagement meetings with your portfolio companies? (i.e. meet with representatives from the board of directors or the executive management to discuss corporate governance and corporate social responsibility matters)



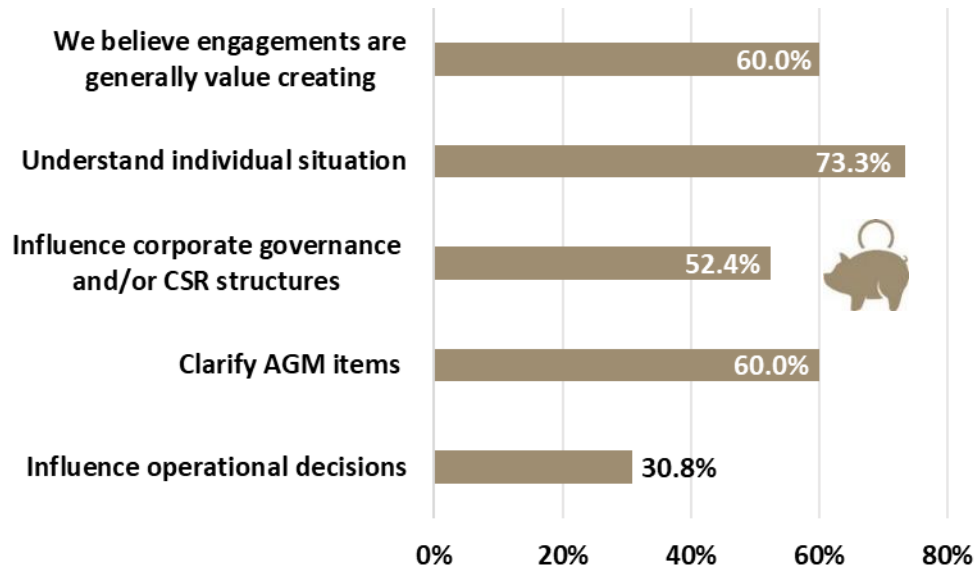
Engagements – Bridge the Gap (II/IV)

Reasons for engaging

Why are engagements conducted?

Survey 2019; only investors *participating* in engagements*

Percentage values reflect answers *agree* and *fully agree*



- A majority of institutional investors considers engagements as value-creating
- The main reason to hold engagements is to better understand the individual company
- International asset managers generally use engagements to influence investee companies' governance frameworks

Question: Why do you conduct corporate governance engagements with your portfolio companies?

* Only aggregate sample shown due to small sample size of some individual categories



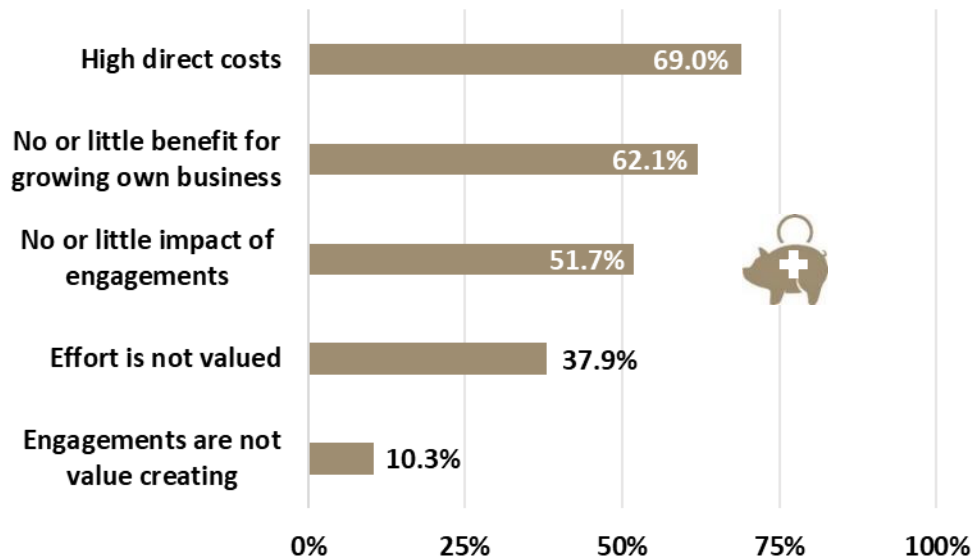
Engagements – Bridge the Gap (III/IV)

Reasons for not engaging

Why are engagements not conducted?

Survey 2019; only Swiss-investors *not* conducting engagements*

Percentage values reflect answers *agree* and *fully agree*



- The main reason for Swiss investors to *not* conduct engagements are costs
- 62% of Swiss investors who are not conducting engagements are convinced that this adds little benefit to their business

	Pension funds	CH asset managers
Engagements are not value creating	18.8%	0.0%
Effort is not valued	50.0%	33.3%
No or little impact of engagements	57.9%	40.0%
No or little benefit for growing own business	77.8%	44.4%
High direct costs	73.7%	60.0%

Question: What is/are the reason(s) for you to not conduct corporate governance engagement meetings with your investee companies?

* The sample of Non-Swiss investors is too small



Engagements – Bridge the Gap (IV/IV)

Implications

The SWIPRA Survey 2019 results again show the importance of engagements to bridge gaps and effectively achieve a mutual understanding of the individual company and its CSR efforts over time.



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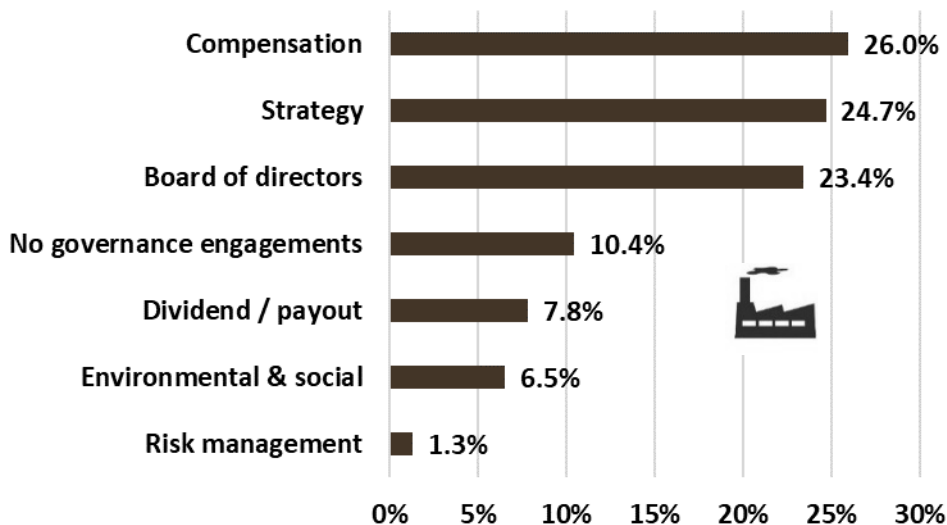


Corporate Governance and CSR (I/VI)

Key engagement topics

Engagement focus of institutional shareholders

Survey 2019; issuers only



- Engagements are still mostly focused around the key pillars of corporate governance, such as compensation, strategy, and board of directors
- CSR is not a stand-alone engagement topic, but integrated into the overall governance discussion

Question: Which was your institutional shareholders' primary governance engagement topic during the financial year 2018?

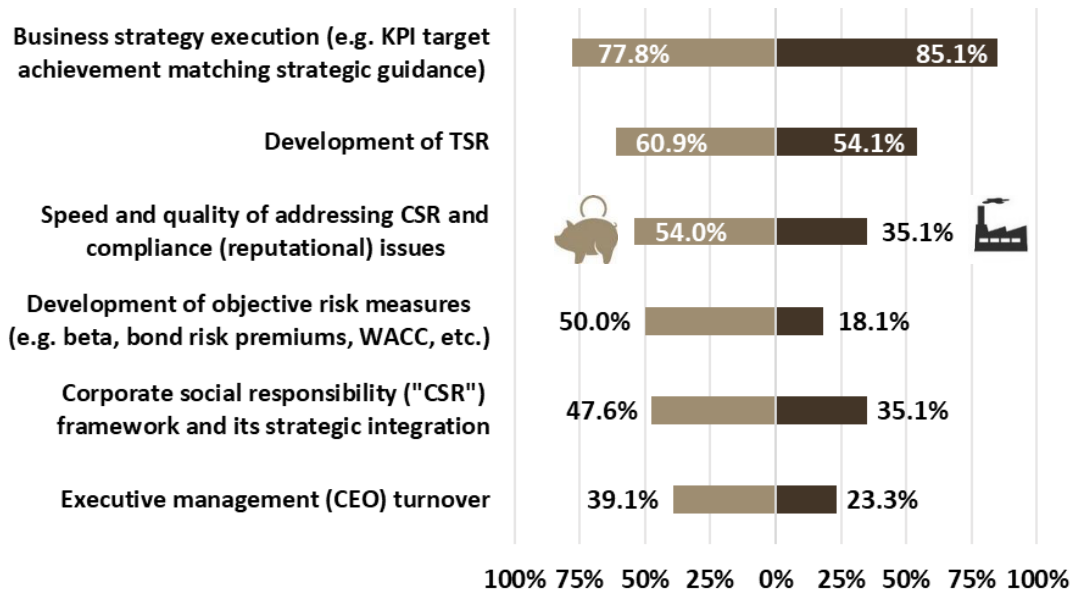


Corporate Governance and CSR (II/VI)

CSR in the assessment of the board of directors

CSR framework and strategic integration increasingly important

Survey 2019, Percentage values reflect answers *suitable* and *very suitable*



- CSR will increasingly impact shareholders' performance evaluation of their boards
- 47.6% of the investors deem the CSR framework and its integration into corporate strategy a (very) suitable measure for board performance
- Similarly, *how* issuers deal with CSR issues is considered a (very) suitable board performance measure by 54.0% of investors

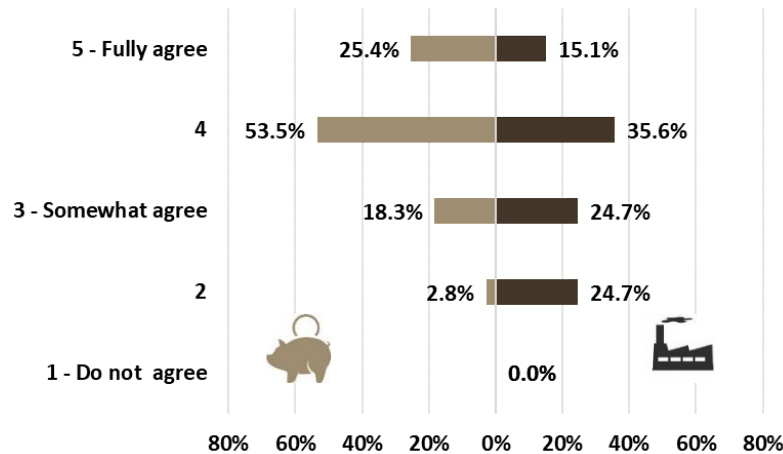
Question: How suitable are the following indicators to measure the performance of a board of directors? Development of TSR - Business strategy execution (e.g. KPI target achievement matching strategic guidance) - Executive management (CEO) turnover - Corporate social responsibility ("CSR") framework and its strategic integration - Speed and quality of addressing CSR and compliance (reputational) issues - Development of objective risk measures (e.g. beta, bond risk premiums, WACC, etc.)



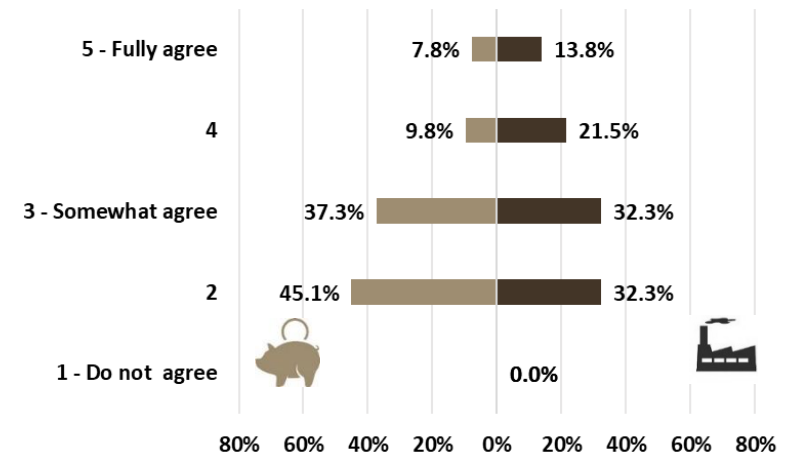
Corporate Governance and CSR (III/VI)

Need to reflect CSR in compensation systems...

**CSR targets guide behavior towards long-term sustainability
Survey 2019**



**CSR performance already reflected in financial performance
Survey 2019**



- CSR has also become a key discussion topic in compensation matters
- 78.9% of the investors consider CSR targets in compensation systems as key to long-term sustainability, only 50.7% of the issuers agree with this
- 35.3% of the issuers believe that CSR performance is reflected sufficiently in financial performance, only 17.6% of the investors agree

Question: [left] CSR targets are necessary to guide individual behavior towards long-term sustainability and should be included in compensation systems, [right] CSR performance is implicitly reflected in the development of financial performance and should not be included in compensation systems

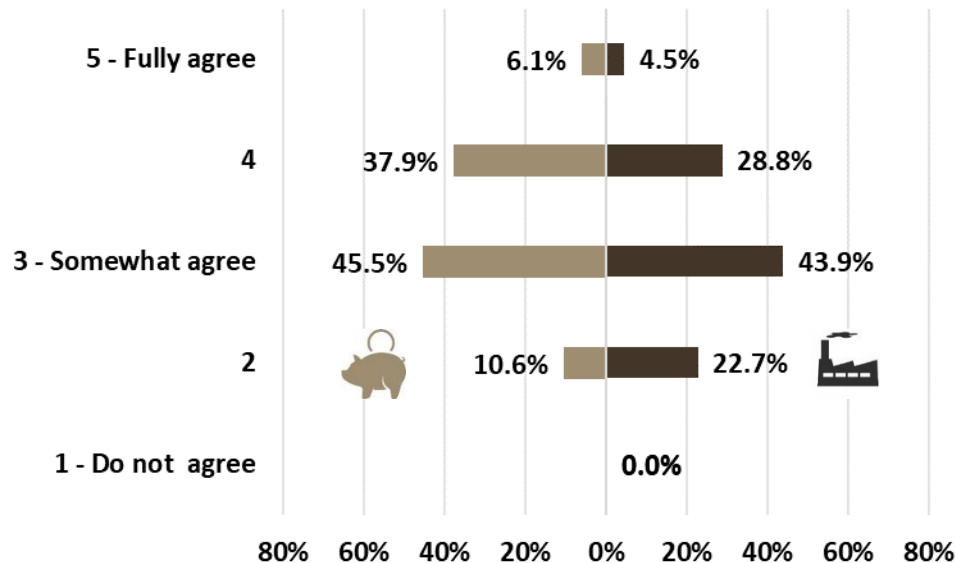


Corporate Governance and CSR (IV/VI)

Despite increased board discretion

CSR targets increase board discretion in variable compensation

Survey 2019



	Pension funds	CH asset managers	Int. asset managers
5 - Fully agree	7.4%	4.5%	5.9%
4	33.3%	50.0%	29.4%
3 - Somewhat agree	44.4%	45.5%	47.1%
2	14.8%	0.0%	17.6%
1 - Do not agree	0.0%	0.0%	0.0%

- 44% of the investors, mainly Swiss, believe that CSR compensation targets will increase the board's discretion in assessing performance achievements
- After years of continuous reductions of board discretion in compensation decisions, investors seem willing to soften this stance in favor of CSR targets

Question: CSR targets generally increase a board of directors' discretion in the variable compensation performance assessment

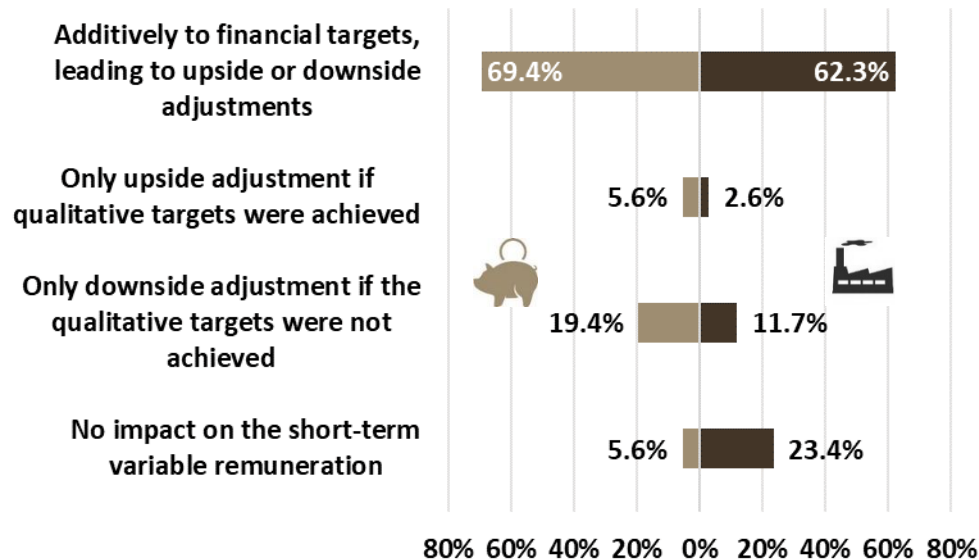


Corporate Governance and CSR (V/VI)

How to reward CSR in compensation systems

Impact of qualitative (CSR) performance targets on compensation

Survey 2019



- Unlike in the previous year, investors believe CSR-related qualitative performance targets should be treated like financial KPIs, with an upside and a downside potential
- Realization in the market that CSR not only entails risks, but also opportunities

	Pension funds	CH asset managers	Int. asset managers
Additively to financial targets	51.7%	78.3%	85.0%
Only upside adjustment	3.4%	8.7%	5.0%
Only downside adjustment	34.5%	13.0%	5.0%
No impact on the short-term variable remuneration	10.3%	0.0%	5.0%

Question: How should the achievement of qualitative targets (e.g. ethical behavior, functioning compliance, working risk management, etc.) influence the level of short-term variable remuneration?



Engagements – Bridge the Gap (VI/VI)

Implications

CSR has to be seen, assessed and reported integrated into key governance processes and elements such as:

- **The board of directors' composition and decision making**
 - **Corporate strategy**
 - **Strategic risk management**
 - **Remuneration incentives**
-



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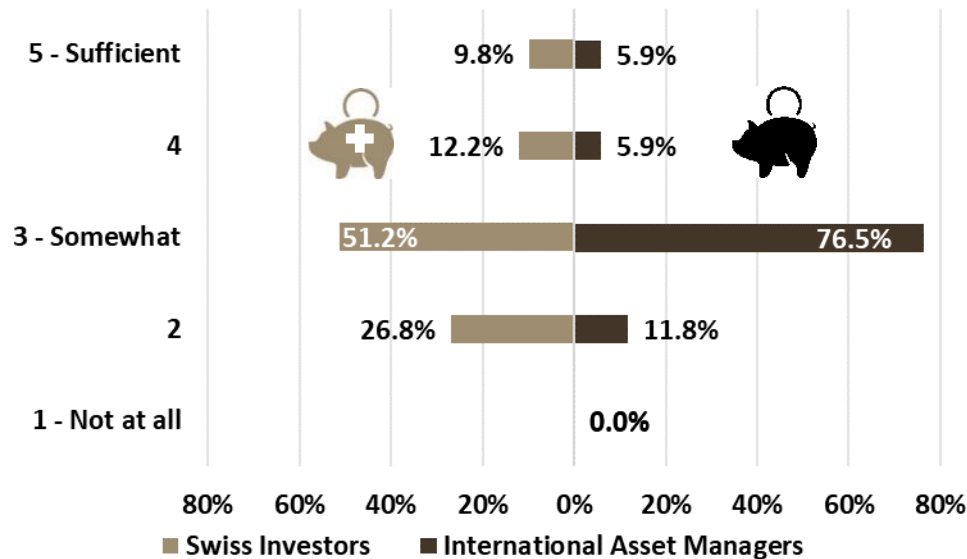


Board of Directors (I/IV)

Board responsibility and CSR

Is the board taking sufficient responsibility in CSR?

Survey 2019



- Only a minority, 22.0% of Swiss and 11.8% of non-Swiss Investors, believes that boards of Swiss companies take sufficient responsibility in CSR topics
- This does not necessarily mean that the board does not do enough, but in light of the previous findings, it can well be that this effort is not made sufficiently transparent

	Pension funds	CH asset managers	Int. asset managers
5 - Sufficient	18.2%	0.0%	5.9%
4	13.6%	10.5%	5.9%
3 - Somewhat	45.5%	57.9%	76.5%
2	22.7%	31.6%	11.8%
1 - Not at all	0.0%	0.0%	0.0%

Question: In your view, do Swiss-listed companies, in particular their boards of directors, generally take sufficient responsibility in CSR topics?

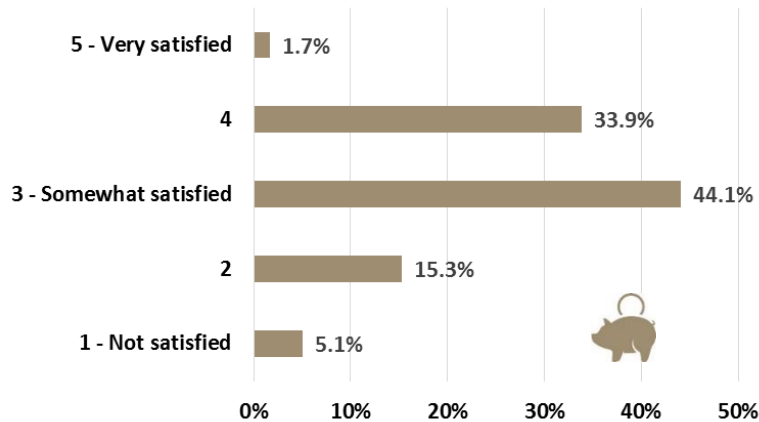


Board of Directors (II/IV)

Board succession and composition

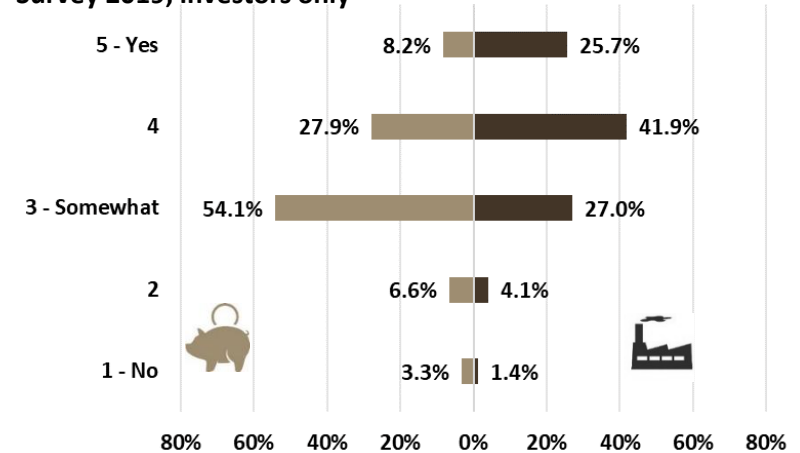
Disclosure on composition and rotation

Survey 2019; investors only



Structured to ensure independent decision making

Survey 2019; investors only



- In the survey 2018, more than 75% of the investors and 92% of issuers considered board composition and rotation a (very) important topic, though only 35.6% of the investors are satisfied with the related disclosure according to the survey 2019
- 67.6% of the issuers consider the structure of boards of directors appropriate to allow independent decision making, but only 36.1% of the investors share this opinion

Question: [left] How satisfied were you with the information disclosed by Swiss companies on their board of directors' composition and the related rotation processes?
[right] In your view, are boards of directors of Swiss companies generally set up appropriately to ensure independent decision making and functioning checks and balances?

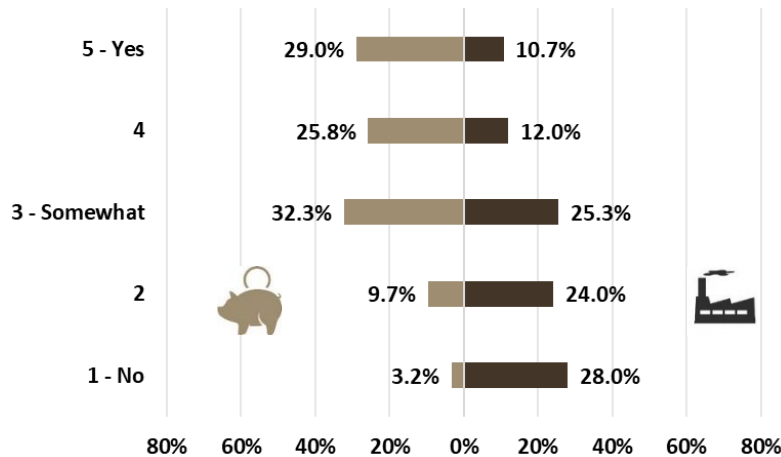


Board of Directors (III/IV)

Board structure and independence

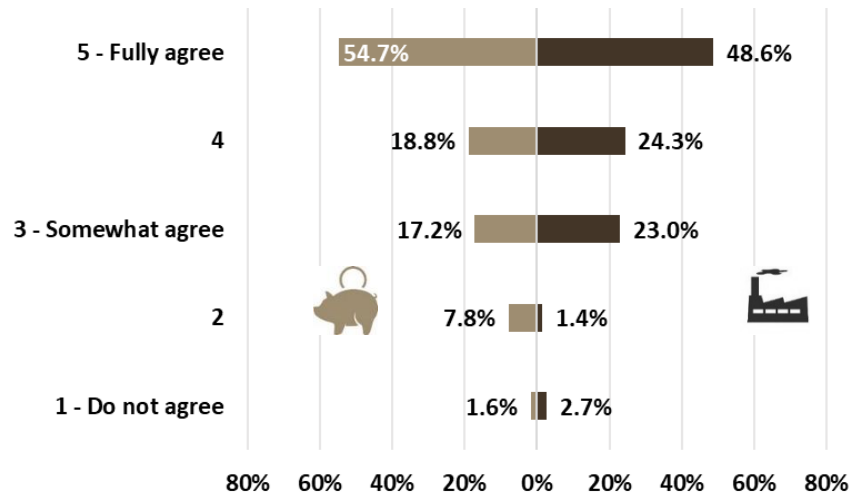
Impact of information asymmetry within the board

Survey 2019; investors only



Independence of board committee chairs

Survey 2019; investors only



- Only 22.7% issuers, but 54.8% of investors consider a large information asymmetry on the board to diminish individual directors' contribution to the overall body
- There is broad agreement amongst market participants that committee chairs should be independent not only from management, but also from the chairman of the board

Question: [left] Boards of directors are primarily guided by their chairperson and/or the chairperson together with the CEO, while other members of the board of directors tend to be less informed. Does this information asymmetry diminish the potential contribution of these other members to the board of directors? [right] Committee chairs should, in general, be experienced in their role and independent from the chairperson of the board of directors and the executive management.



Board of Directors (IV/IV)

Implications

Boards will be increasingly challenged by stakeholder expectations regarding their organizational and independent decision making processes, their dealing with CSR in corporate strategy and incentive schemes and an integrated disclosure.



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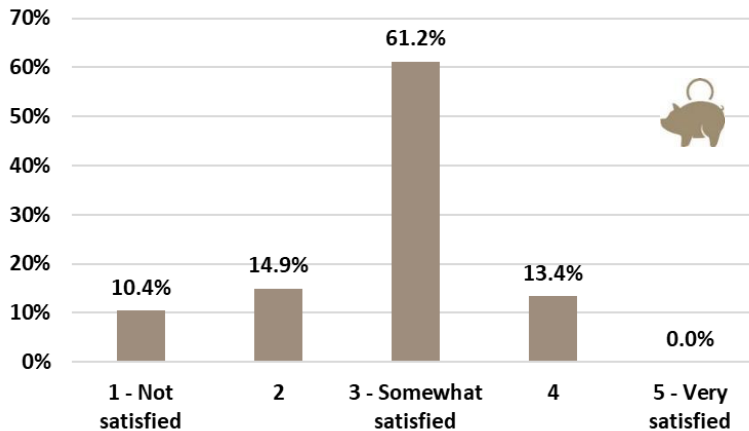


Additional topics (I/V)

Compensation - Pay for performance

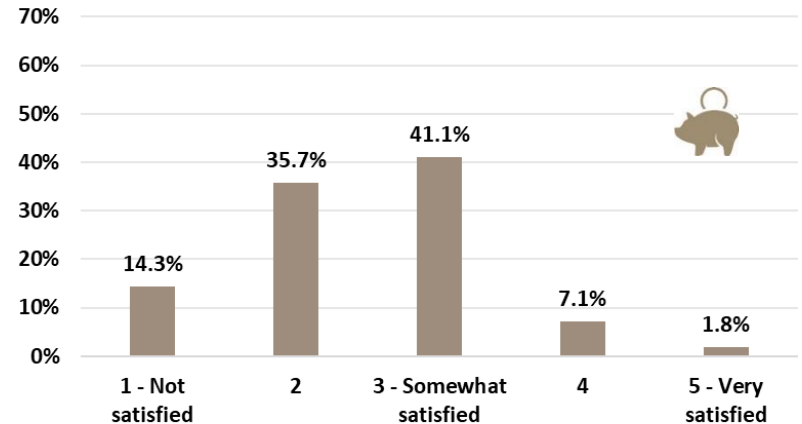
Comprehensibility of pay for performance reporting

Survey 2019; institutional investors only



Comprehensibility of pay for performance reporting

Survey 2016; institutional investors only



- Investors remain critical with the pay for performance disclosure of Swiss companies, but the fraction of investors not satisfied has dropped from 50% in 2016 to 25.3% in 2019

Including CSR-related performance indicators in variable compensation will increase shareholder scrutiny and require issuers to increase the level of disclosure in order to ensure the traceability of pay for performance.

Question: [left] How do you assess the comprehensibility with regard to the alignment of achieved performance targets and the payout of variable short-term compensation elements (pay for performance) for the reporting period 2018 in Switzerland? [right] How satisfied were you with respect to the issuers' disclosure regarding the comparison of achieved performance targets and the respective payout of variable compensation elements (pay for performance) during the AGM season 2016?

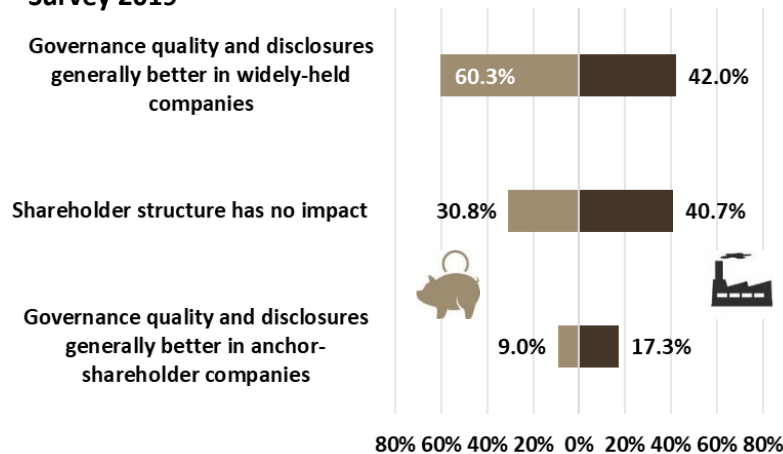


Additional topics (II/V)

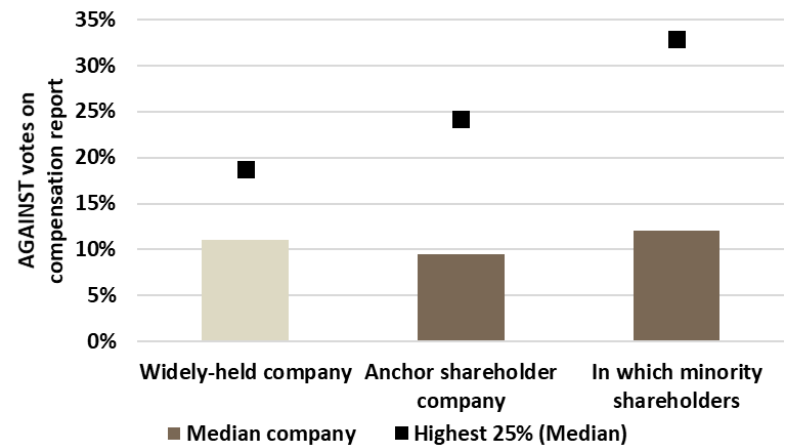
Anchor Shareholder Companies - Governance quality and disclosure

Impact of shareholder structure on governance and disclosure

Survey 2019



Impact of shareholder structure on AGM voting SWIPRA AGM Analysis 2019



- Investors generally believe that anchor-shareholder* companies have a worse governance structure and poorer related disclosure than widely-held companies
- This is aligned with the results of the SWIPRA AGM analysis showing a higher level of against votes among minority shareholder in anchor-shareholder companies

Question: In your view, does a company's shareholder structure impact its quality of corporate governance and disclosure in general?

*Companies with a single shareholder holding at least 10% of the shares outstanding

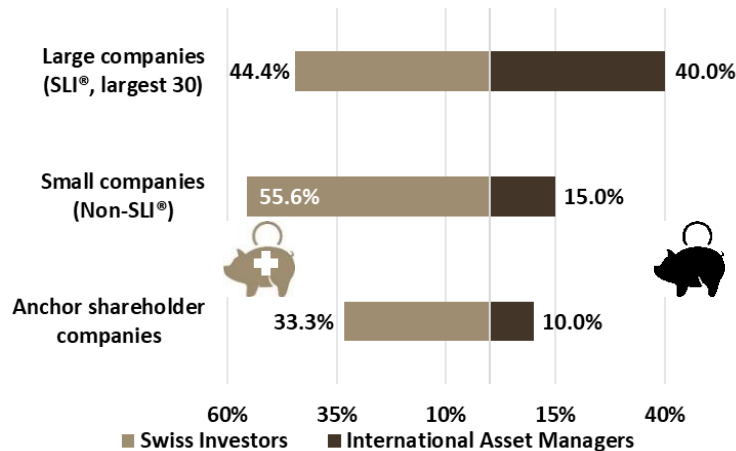


Additional topics (III/V)

Anchor Shareholder Companies - Engagement Access

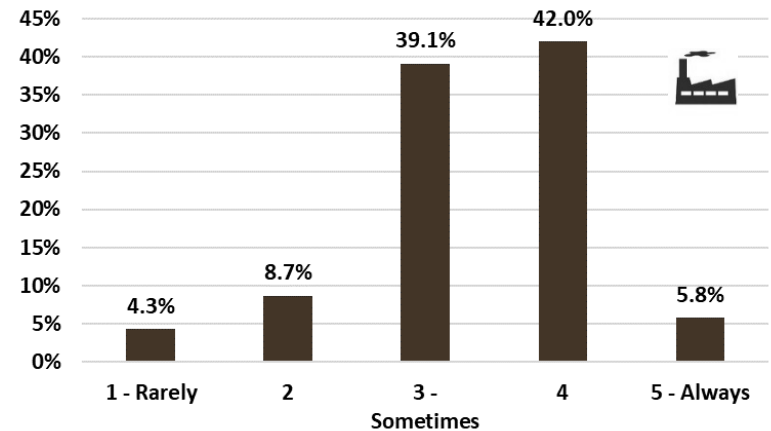
Engagement access in Swiss companies

Survey 2019; percentage values reflect answers *rather yes* and *yes*



Responsiveness of investors to issuers' requests

Survey 2019



- Anchor shareholder and small companies rather engage with Swiss than non-Swiss investors
- Close to 50% of the investors generally respond well to issuers' engagement requests

Despite their perceived lower quality governance and often specific governance structures, anchor shareholder companies seem less willing to engage with investors in order to explain their structures and close the gap.

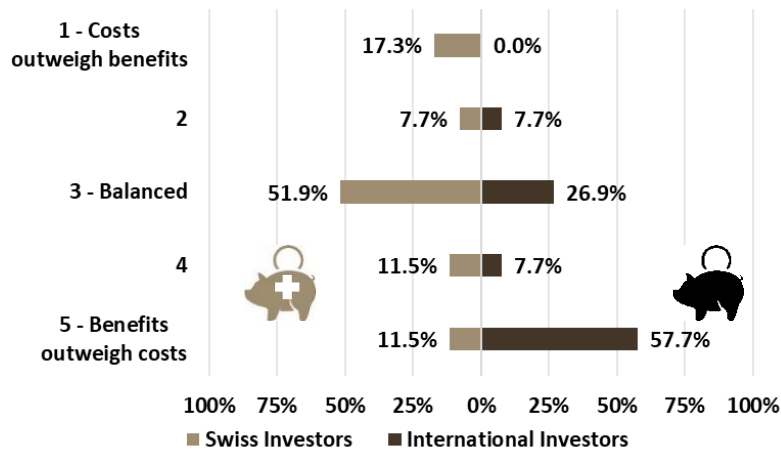
Question: [left] Do you get sufficient access to the board of directors and particularly the chairperson of Swiss-listed companies? [right] Are your institutional shareholders generally responsive if you are looking for corporate governance engagement meetings (outside of normal business/financial roadshows)?



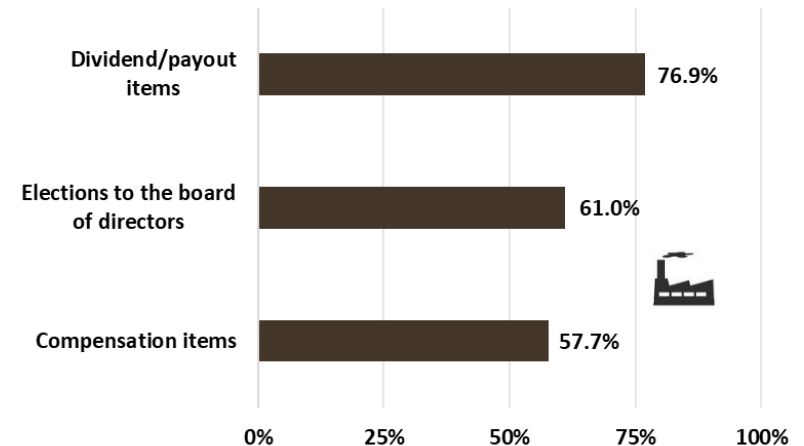
Additional topics (IV/V)

AGM voting - Benefits and costs

Balance between costs and benefits of voting at AGMs Survey 2019



Are shareholders voting diligently enough at AGMs Survey 2019; issuers only



- 57.7% of international and only 11.5% of Swiss investors clearly see the benefits of voting at AGMs outweighing the incurring costs

Shareholder voting rights are still considered to be more of a burden than a privilege by Swiss investors, but those who do vote at AGMs take their decisions diligently.

Question: [left] How do you assess the cost-benefit of voting at AGMs? [right] In your view, are institutional shareholders generally acting sufficiently diligent when taking their voting decisions at annual general meetings on...

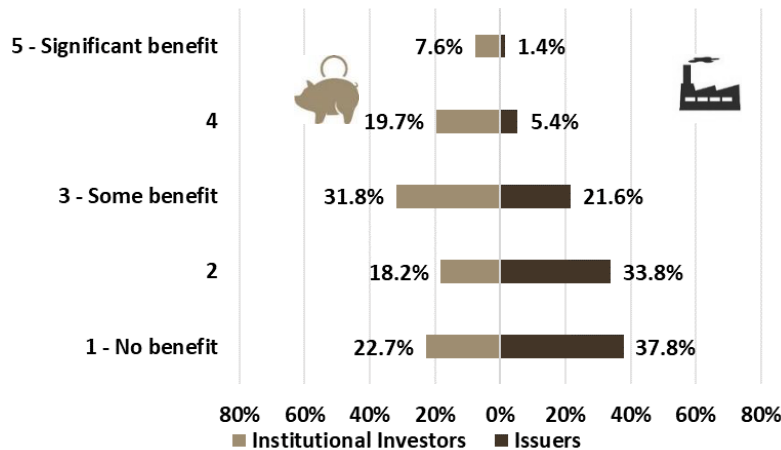


Additional topics (V/V)

External Audit and CSR

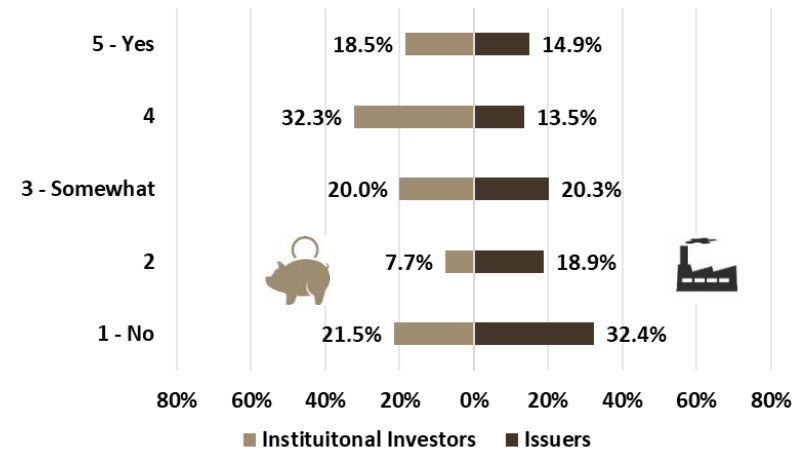
Benefit of external audit of CSR reporting

Survey 2019



Benefit of external audit on effectiveness of internal control system

Survey 2019



- Fewer investors see a truly positive benefit of an external audit on the CSR reporting, but rather consider an external audit of the internal control system as beneficial.

The benefit of the external audit related to CSR is no longer perceived to be in the review of the disclosure, but rather the assurance of the internal control effectiveness.

Question: [left] Would you expect a benefit from the involvement of the external auditor in the review of corporate reporting on corporate social responsibility, specifically on human rights and the environment? [right] As part of the ordinary audit, the external auditors examine whether an internal control system exists. Would you expect a benefit from additional assurance by the external auditor on the effectiveness of the internal control system (shift from internal to external audit)?



Further scope of the SWIPRA Survey 2019

Some of the additional questions also covered by the SWIPRA survey 2019:

Regulation

- Should proxy advisors be regulated? And if so, how?
- Should it become easier for shareholders to submit AGM proposals?
- Should Swiss asset managers be legally required to vote at AGMs?

AGM

- What are appropriate approval rates for board elections?

Compensation

- Are companies constrained by external factors when structuring their compensation?
-



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