



SWIPRA  
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P R O X Y  
A D V I S O R

## **AGM Season 2017 and beyond**

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**Corporate governance framework,  
board elections, value reporting, payout policy**

**An outlook by SWIPRA**

Zurich, January , 2017



# Agenda

- Introduction
- Observations & developments
- Key issues 2017 and beyond
  - Board of directors
  - Management incentives
  - Corporate social responsibility
  - Value reporting
  - Payout

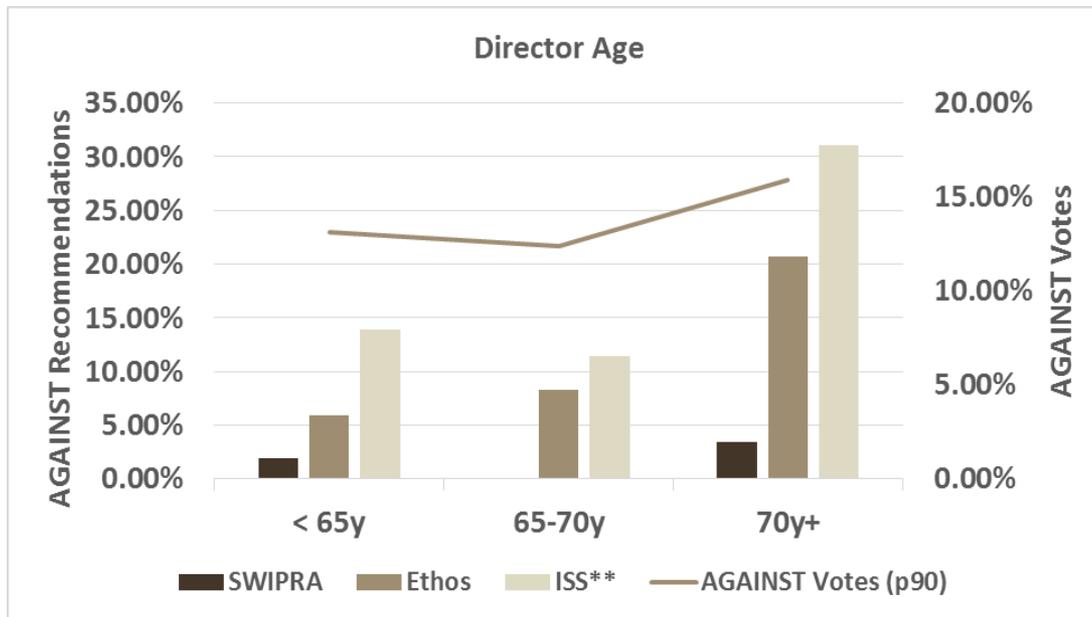


# Observations & developments (I)

## Increasing focus on sub-aspects of governance

### SWIPRA AGM Analysis 2016

Against recommendations of the three proxy advisors are shown in bars according to the scale on the left. The average of shareholders' against votes for the 10% most controversial director elections is shown as line according to the scale on the right.



The analyzed sample contains observations for the 100 largest SPI® companies that held their AGM between July 2015 and May 2016 and for which data is available.

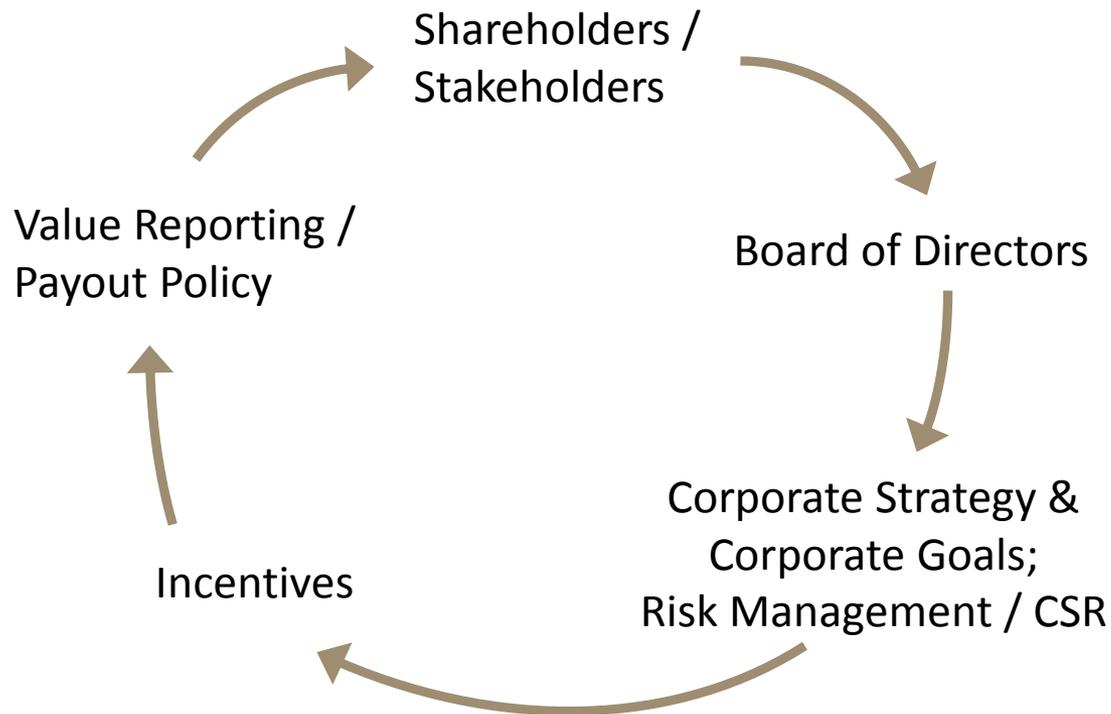
\*\* ISS recommendations are not publicly available. The analysis approximates ISS recommendations by considering publicly available voting reports of market participants that relate their voting policy to the ISS proxy voting guidelines.

- There has been an increasing focus in recent years on various sub-aspects of corporate governance.
- Examples are the “right” age and tenure limits for board members or the length of vesting periods for long-term incentives.
- Those sub-aspects were generally subject to fairly stringent minimum/maximum thresholds.



## Observations & developments (II)

### Back to the big picture: the corporate governance framework



- The focus on sub-aspects has increasingly led to a negligence of overarching governance processes.
- Such processes cannot be managed by applying stringent “one size fits all” policies.
- SWIPRA’s scientifically-based policy considerations thus focus explicitly on the links between the main drivers of these processes.
- Survey evidence further confirms that the market increasingly shares this view.



## Key issues for AGM season 2017 and beyond (I)

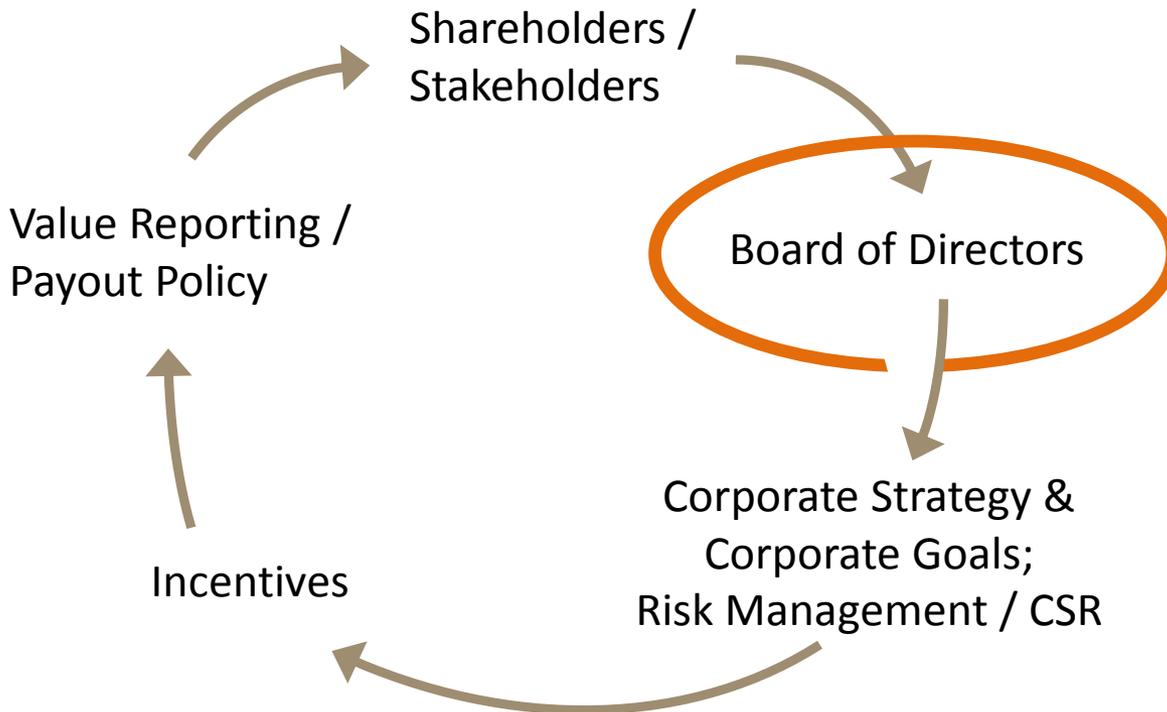
- **Truly independent acting** of the board of directors and its committees combined with provision of necessary information.
- **Relations** between corporate strategy, performance incentives, target achievements and actual compensation.
- **Comprehensible description of CSR**, its importance and the respective responsibilities within the company.
- **Effective value reporting** by transparently communicating these processes.
- **Comprehensive payout policy** embedded in the company's cash management.
- **Stakeholder communication and engagements.**



# Key issues for AGM season 2017 and beyond (II)

## Corporate Governance Framework

Do not forget the big picture



- The most important aspect for boards to be able to work in the best interest of their stakeholders is their *overall independence*.
- What defines independence and at what level should it be measured?
- SWIPRA's policy considerations clearly focus on processes and the portfolio of board members and less on individual members.



## Key issues for AGM season 2017 and beyond (III) Board of directors – Assessing independence

- To apply **rigid criteria** such as age and tenure limit is not sufficient to verify whether a board of directors will be able to **act independently**.
- As pointed out in its Policy Considerations, SWIPRA will instead primarily focus on whether **independent *behavior*** can be expected from a board nominee.
- In SWIPRA's opinion, e.g. a board's independence from management does not necessarily mean there would be no room for a CEO on the board.
- SWIPRA CG Survey 2016: Board's **independence from management and large shareholders** is highly relevant.



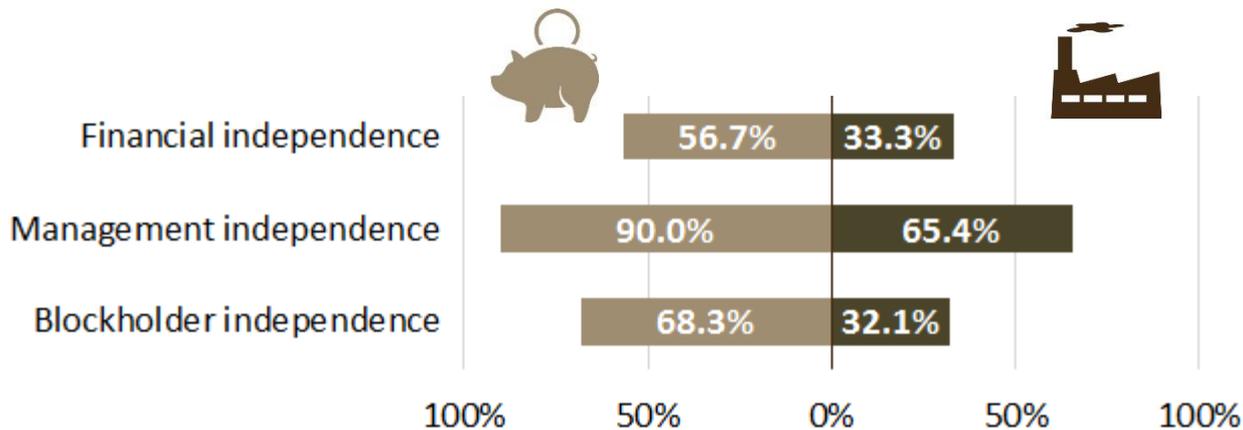
# Key issues for AGM season 2017 and beyond (IV)

## Board of directors – Assessing independence

### SWIPRA Corporate Governance Survey 2016 – Percentage of “relevant” or “very relevant” responses

Question investors: Please indicate the relevance of the following factors in evaluating a proposed candidate for the board of directors in a company listed in Switzerland.

Question issuers: Please indicate the relevance of the following factors for selecting a candidate for the board of directors of your company.



- For 90% of the investors, the board's independence from management is of very high relevance.
- For almost 70% of the investors, the same is true for overall independence from blockholders.



## Key issues for AGM season 2017 and beyond (v) Board of directors – Assessing independence

- SWIPRA derives indications of future behavior as a board member from common factors, but we pay particular attention to the **competence of board members**.
- To ensure the necessary portfolio of skills to set the strategy and functioning checks and balances, boards need a well-managed **rotation process**. Basis for this is a **dynamic skill mapping for board members**.
- It is thus important that shareholders are able to understand these processes through adequate disclosure.



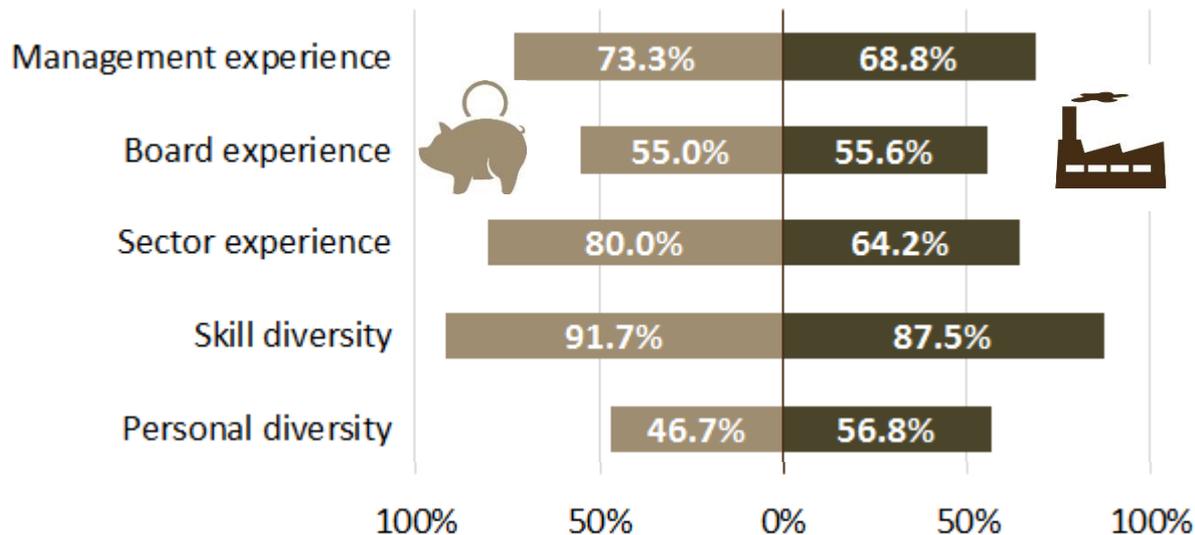
# Key issues for AGM season 2017 and beyond (VI)

## Board of directors – Assessing independence

### SWIPRA Corporate Governance Survey 2016 – Percentage of “relevant” or “very relevant” responses

Question investors: Please indicate the relevance of the following factors in evaluating a proposed candidate for the board of directors in a company listed in Switzerland.

Question issuers: Please indicate the relevance of the following factors for selecting a candidate for the board of directors of your company.



- Independence is achieved through a diversity of knowledge and experience on the overall board level.
- Judging the portfolio of skills and experience is an important task for shareholders when electing board members.



## Board of directors: Key messages

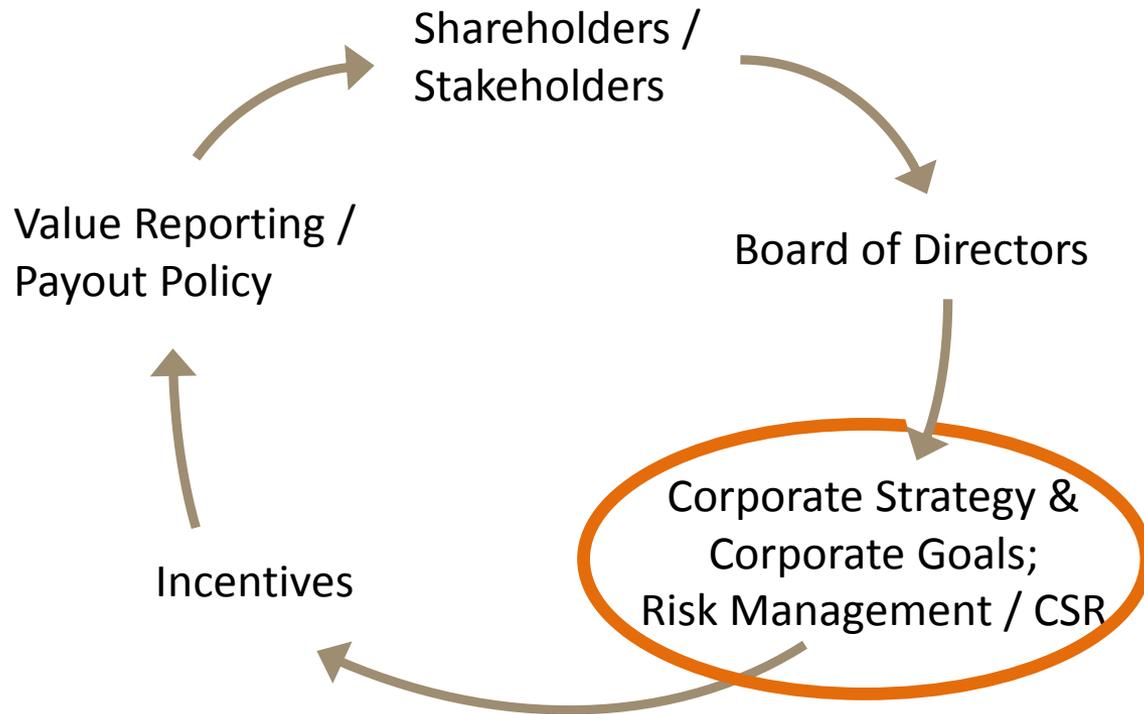
- Board independence should be measured at the level of the *overall* board and the board *committees*.
- Independent decision-making of the board requires the right mix of *knowledge* and *experience*.
- To obtain the right mix of skill and experience on the board, an *active rotation process* based on a dynamic skill map is needed.
- Issuers should be more *transparent* regarding these topics.
- **SWIPRA will continue to attach great importance to understand skill mapping and active board rotation processes.**



# Key issues for AGM season 2017 and beyond (vii)

## Corporate Governance Framework

Do not forget the big picture



- The board of directors decides on the overall strategy of the company.
- Key drivers of the strategy should be part of the performance-based compensation elements.
- SWIPRA's policy considerations further stress that strategy formulation should not focus on shareholders only, but address all stakeholders by actively pursuing CSR targets.



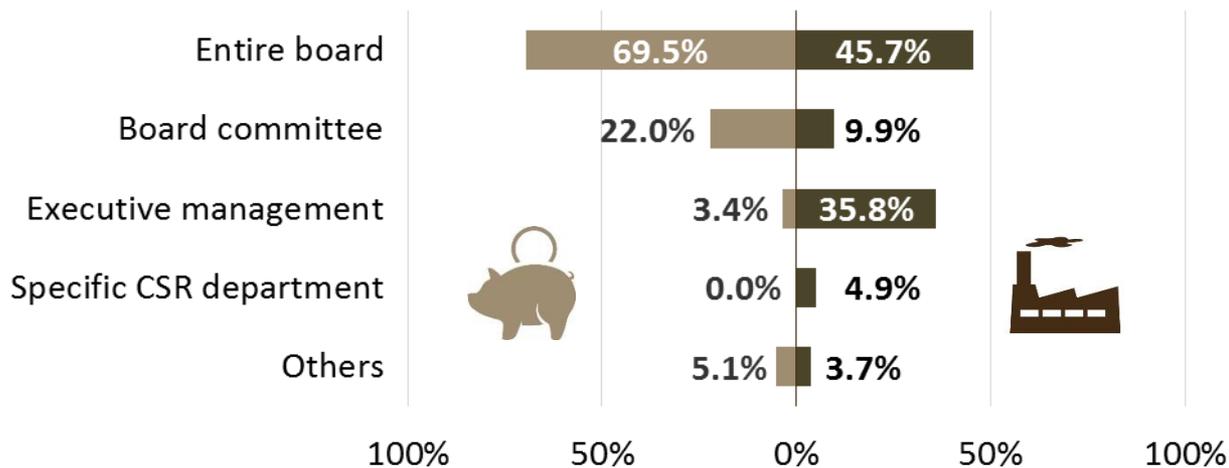
# Key issues for AGM season 2017 and beyond (VIII)

## CSR: Who is responsible?

### SWIPRA Corporate Governance Survey 2016

Question investors: In your opinion, who should be in charge of defining the corporate social responsibility strategy in a company?

Question issuers: Who is in charge of defining the corporate social responsibility strategy in your company?



- Investors' opinion confirms that responsibility for CSR should be with the board of directors.
- This is less true for companies where there is still a large fraction believing that the executive management should be in charge of CSR.



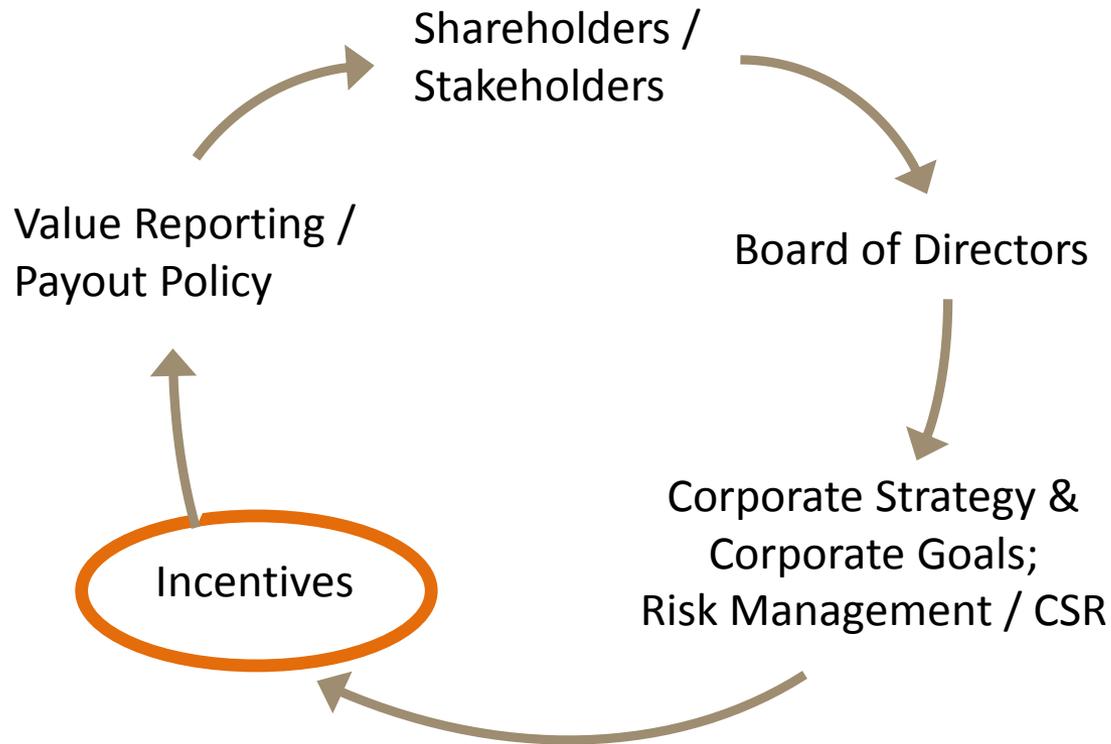
## Corporate Social Responsibility: Key messages

- CSR does not only expose companies and the responsible bodies to reputational risks, but also to concrete financial risks as well as potential opportunities.
- CSR should thus lie in the responsibility of the board of directors and should become an actively managed part of a company's strategy, risk management and incentive schemes.
- Processes and decisions implemented by the board of directors in connection with CSR need to be communicated to stakeholders.
- **SWIPRA continues the discussion about the extent to which CSR aspects are incorporated in the business strategy, the risk management and the compensation system.**
- Remark: Political topic in Switzerland: **“Responsible business initiative”**.



# Key issues for AGM season 2017 and beyond (IX) Corporate Governance Framework

Do not forget the big picture



- Setting the right financial and non-financial incentives is crucial to achieve strategic goals.
- Alignment between pay and relevant key performance indicators needs to be traceable.
- Besides stressing a tangible pay-performance relation, SWIPRA's policy considerations also put emphasis on whether set incentives are an appropriate reflection of strategy and culture.



## Key issues for AGM season 2017 and beyond (x) Incentives: comprehensive and accountable?

- As described in the SWIPRA Policy Considerations, a well-calibrated **pay for performance** system is an important value driver and risk-controlling device.
- **An adequate disclosure** is necessary for shareholders to understand how compensation relevant performance indicators are aligned with a company's overall strategy and cultural targets.
- Institutional shareholders have continuously expressed **dissatisfaction** with the quality of pay-performance disclosure (SWIPRA CG Survey 2016 and before).

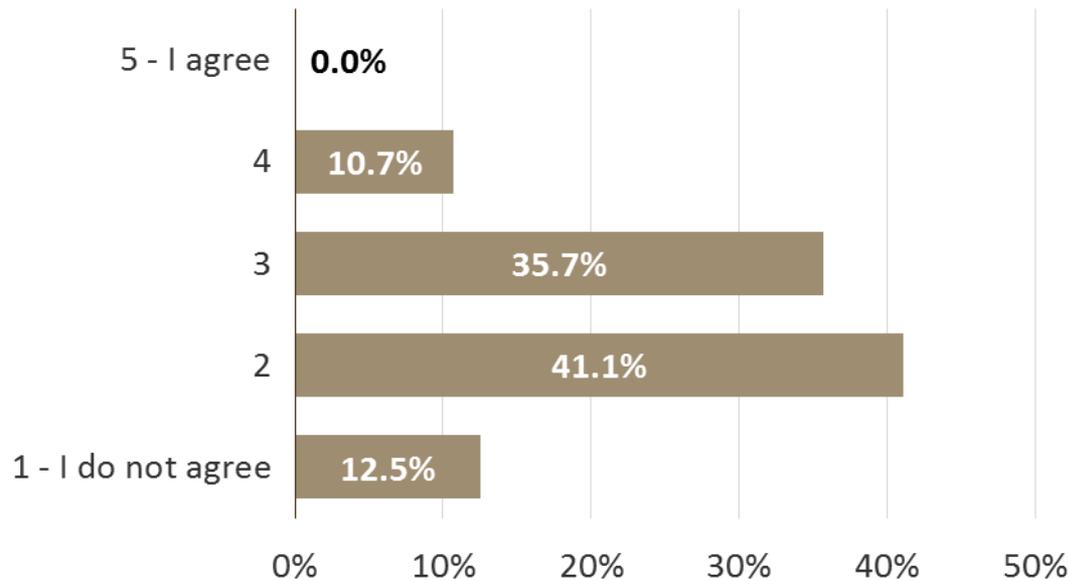


# Key issues for AGM season 2017 and beyond (XI)

## Incentives: comprehensive and accountable?

### SWIPRA Corporate Governance Survey 2016: Sample: investors only

Question: The compensation of the executive management is in general in a reasonable relation to the disclosed performance of the companies.



- For up to 90% of the investors, pay and performance are currently not in a reasonable relation.
- None of the *international* asset managers observes a reasonable pay-performance relation.



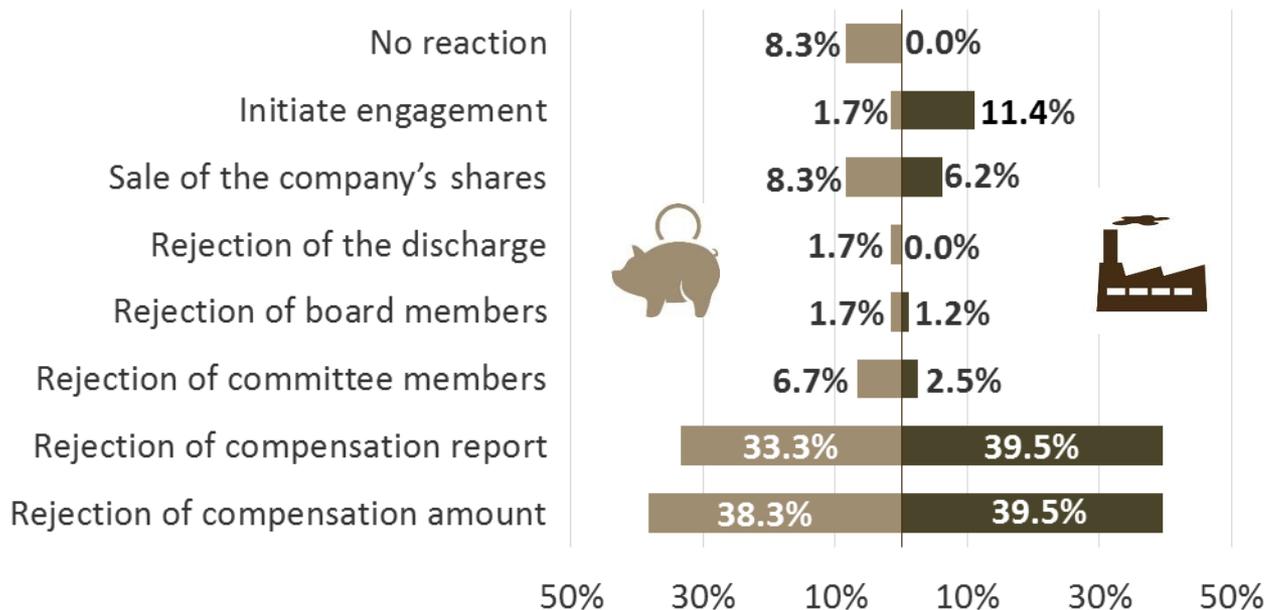
# Key issues for AGM season 2017 and beyond (XII)

## Incentives: investors may draw far-reaching conclusions

### SWIPRA Corporate Governance Survey 2016: primary investor reaction to perceived excessive compensation

Question investors: How will your organization generally react in the event of a, in the view of your organization, excessive compensation package? (primary reaction)

Question issuers: How will your shareholders generally react in the event of a, in the view of your shareholders, excessive compensation package? (expected primary reaction)<sup>1</sup>



- In case of excessive remuneration, one third of the investors would reject the compensation report,
- 38.3% would even reject the proposed amounts with binding votes.



## Incentives: Key messages

- Just calibrating performance-based compensation along certain performance measures is not sufficient.
- Shareholders need to be able to understand how each performance measure maps into the company's overall strategy and culture and vice versa.
- A misalignment of pay with performance may also be seen as an indication of insufficient board oversight, which calls into question the quality of the board.
- Transparently communicating pay for performance enables shareholders to assess whether incentives were appropriately set and helps avoiding rejections of compensation reports, amounts or even the election of members of the compensation committees.
- **SWIPRA will strengthen the focus on the relationship between disclosed strategic corporate targets and compensation incentives to improve traceability in this regard.**



# Key issues for AGM season 2017 and beyond (XIII)

## Corporate Governance Framework

Do not forget the big picture



### Value reporting is key:

- Proper value reporting is based on voluntary disclosure: *not more, but relevant information.*
- The explanation of important processes within the company helps building investor trust.
- As pointed out in SWIPRA's Policy Considerations, communicating how decisions are taken impacts the long-term value of the company.



## Key issues for AGM season 2017 and beyond (xiv) Value-reporting: payout policy

- In SWIPRA's view, every firm should have an **explicit payout policy** and deviations from such a policy are possible but would need to be explained.
- Investors have a clear preference to tie dividends not to previous year's level, but to the **current financial situation** of the company (SWIPRA CG Survey 2016).
- Accordingly, payout should in any case be made through **generated cash flows** and not through outside financing.

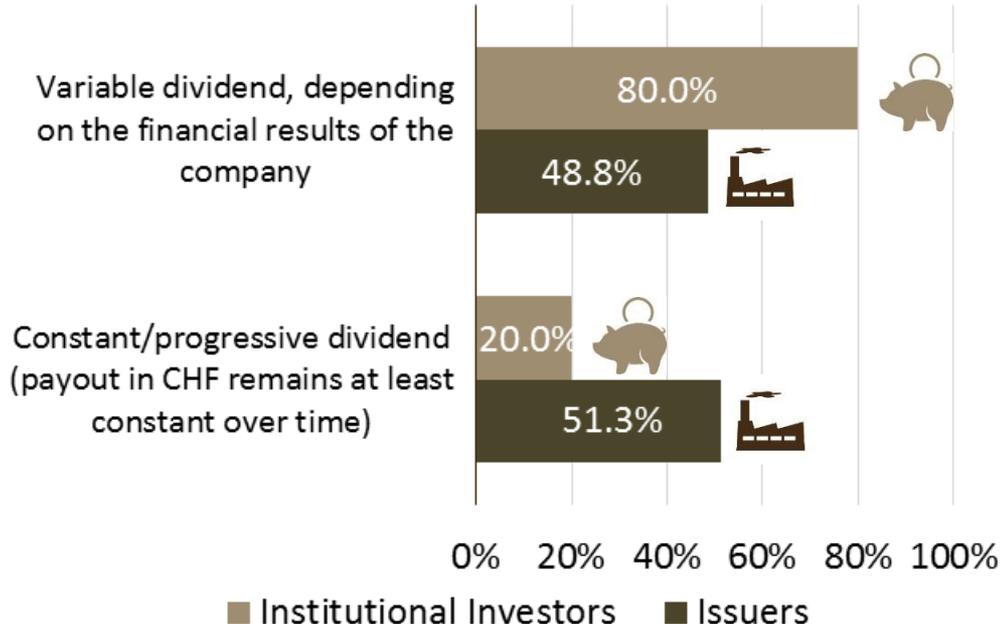


# Key issues for AGM season 2017 and beyond (xv)

## Value-reporting: Payout Policy

### SWIPRA Corporate Governance Survey 2016

Question: What kind of dividend policy do you think is most useful?



- A majority of issuers retain a dividend policy based on absolute payout values.
- Investors have a clear preference to tie dividends not to previous year's level, but to *the current financial situation of the company*.

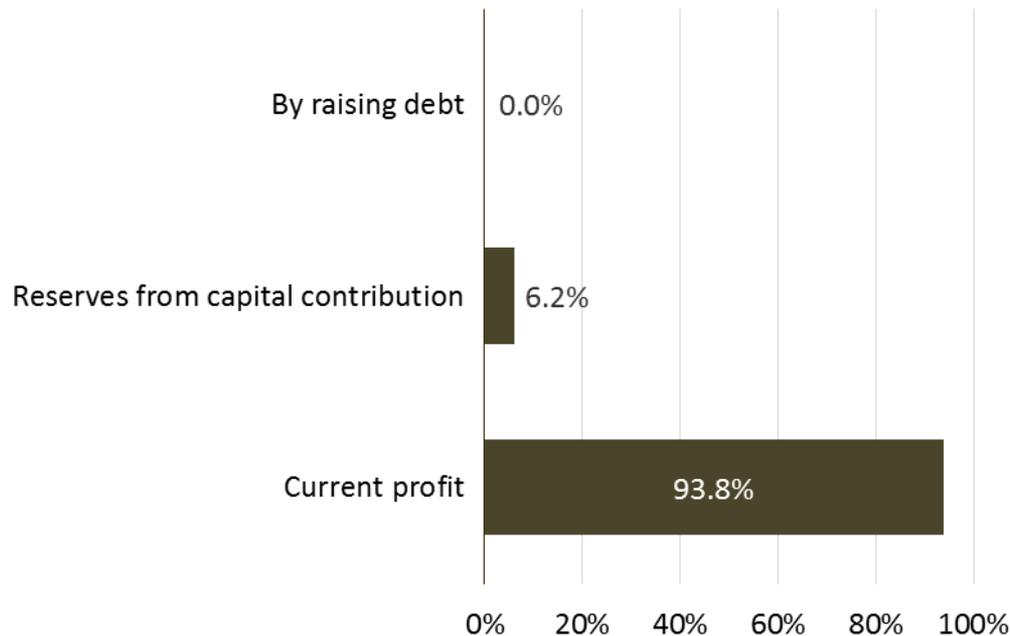


# Key issues for AGM season 2017 and beyond (xvi)

## Value-reporting: Payout Policy

### SWIPRA Corporate Governance Survey 2016: Sample: investors only

Question investors: From your point of view, how should dividends be financed in the most useful way?



➤ According to the vast majority of investors, payout should in any case be conducted *through generated cash flows and not through outside financing.*



## Payout: key messages

- Payout policies should be set relative to a company's current performance and not to absolute amounts or relative to previously paid dividends.
- Relative payout policies allow more flexibility and avoid that companies have to seek outside financing should operations not provide sufficient free cash flow.
- Companies need to respond to investors' preferences for sustainable distribution policies and consider payout a part of the company's cash management.
- **SWIPRA will increasingly focus on the company's payout policy, its financing strategy in this regard and its cash management.**



## Summary and conclusions

- SWIPRA clearly promotes a discussion of a **company's overall governance framework** instead of overly focusing on individual sub-aspects.
- Conclusions of board independence should be drawn on the level of the **entire body** instead of the individual member level and based on a thorough analysis of **skills, backgrounds and experience**.
- A **company's strategy** should be reflected well in **performance-linked compensation** with a transparent disclosure thereof.
- **CSR** should be under the **board's direct supervision** and an integrated part of strategy, risk management and incentive schemes. Respective disclosure is gaining more importance.
- **Payout policies** should be set **relative** to a company's financial performance and financed through **current cash-flow**.

SWIPRA supports investors and companies in their engagement discussions.

In addition to our scientifically based Policy Considerations, this is the practical basis of our analyses of company's overall governance frameworks and our voting recommendations.



**Thank You !**



# APPENDIX



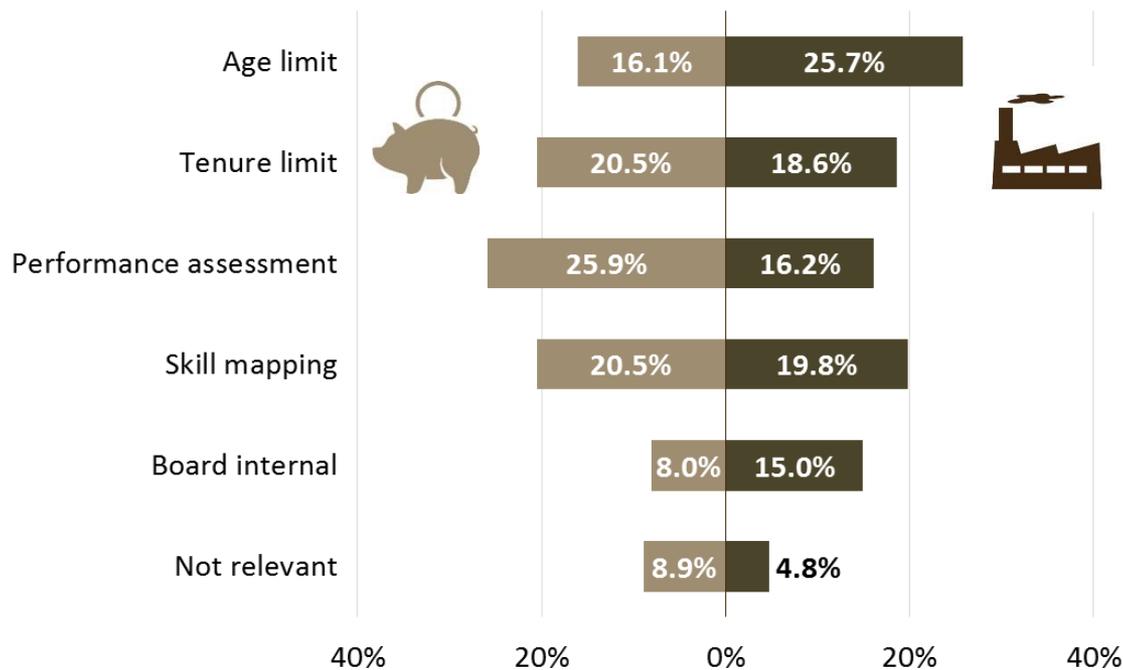
# APPENDIX

## Board of directors – Ensuring capabilities

### SWIPRA Corporate Governance Survey 2016

Question investors (multiple answers possible): How should the board rotation process be managed over time?

Question issuers (multiple answers possible): How is the rotation process of your board of directors managed over time?



- To have the necessary skill to set a strategy and objectively assess the management, every board needs a well-managed rotation process.
- A dynamic skill mapping is an important requirement to ensure that a board is capable to tackle future challenges.

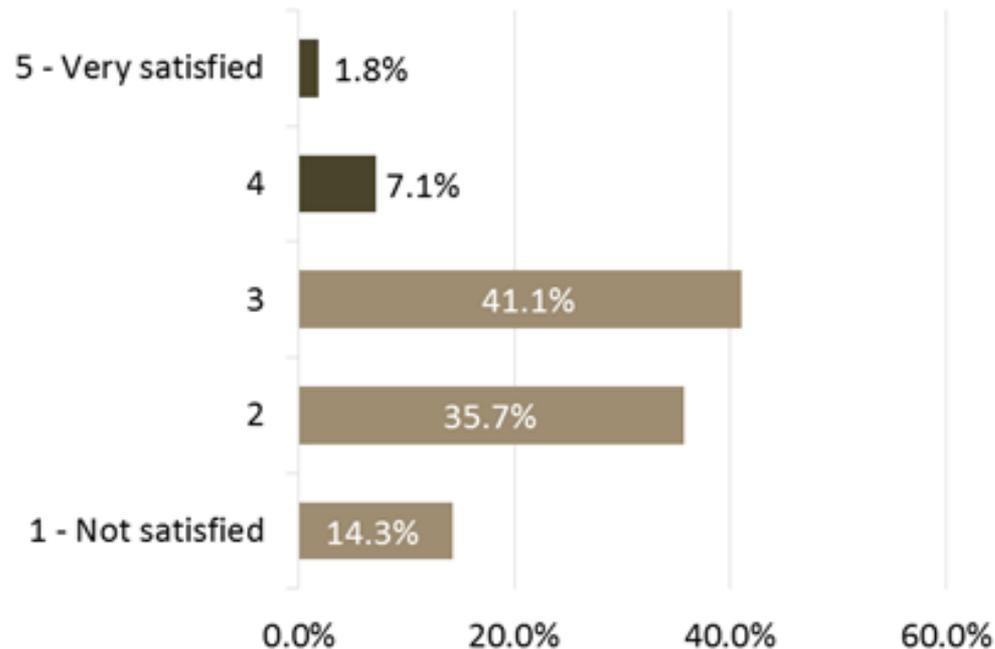


# APPENDIX

## Incentives: communication with stakeholders

### SWIPRA Corporate Governance Survey 2016: Sample: investors only

Question: 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?



- Only 8.9% of the investors are satisfied with the issuers' pay for performance disclosure.
- 17.7% of the issuers spent most of the time on this topics when preparing information on compensation.



# SWIPRA – Swiss Proxy Advisor

SWIPRA is an independent Swiss Proxy Advisor and corporate governance specialist.

With the objective of long-term shareholder value generation, based on principles of value-based management and empirically relevant criteria, SWIPRA provides corporate governance analyses and voting recommendations covering the 50 most highly capitalized shares listed on the SIX Swiss Exchange, composing the SMI Expanded® index.

SWIPRA supports research and education in the area of Corporate Governance through research collaborations with teams of the University of Zurich and engages in regulatory and law-making processes.

## **SWIPRA offers**

1. High level recommendations in terms of quality and reliability
2. Independence and transparency
3. Regular dialogue and engagement with corporate issuers
4. Online tool: research reports, recommendations, voting, individualized reporting



# SWIPRA – Unique approach

## 1. No “one size fits all” approach

- «**Value-based**» instead of «Rule-based» approach, following objective, economic and empirical criteria, focused on long-term value generation
- **Individualized**, company-specific corporate governance research analysis

## 2. Independence and multi-level decision-taking process

- Research analyses and preliminary voting recommendations by Department of Banking and Finance, University of Zurich (“DBF”), final recommendations based on engagement discussions and independent decision by board of trustees
- Continuous dialogue and engagement with companies supporting higher level of transparency and improved communication between stakeholders
- No consulting services, asset management or proxy representation/solicitation

## 3. “One-Stop-Shop”

- Affordable, efficient **platform solution**, addressing compliance requirements regarding **voting and reporting** for institutional investors



## Your contact

### **SWIPRA - Swiss Proxy Advisor**

Ms. Barbara Heller, CEO

Rämistrasse 5

PO Box

CH – 8024 Zurich

Phone +41 44 515 89 68

[Barbara.Heller@swipra.ch](mailto:Barbara.Heller@swipra.ch)

[www.swipra.ch](http://www.swipra.ch)