



Market Discipline and Regulation

A Survey by SWIPRA

2015



SWIPRA Survey

- Corporate Governance Survey 2015 participants
 - All SPI® companies
 - Swiss institutional investors, pension funds and asset managers
 - International institutional asset managers
- In cooperation with researchers at the DBF (UZH)
- Special thanks to:
 - the Pension Fund of Credit Suisse Group (Switzerland) and

D.F. KING

FINANZ und
WIRTSCHAFT

SFAMA
Swiss Funds &
Asset Management
Association

SIX Swiss Exchange

PETRANIX 
Corporate and Financial Communications

 **SHERPANY**
EMPOWERING BOARD & SHAREHOLDERS

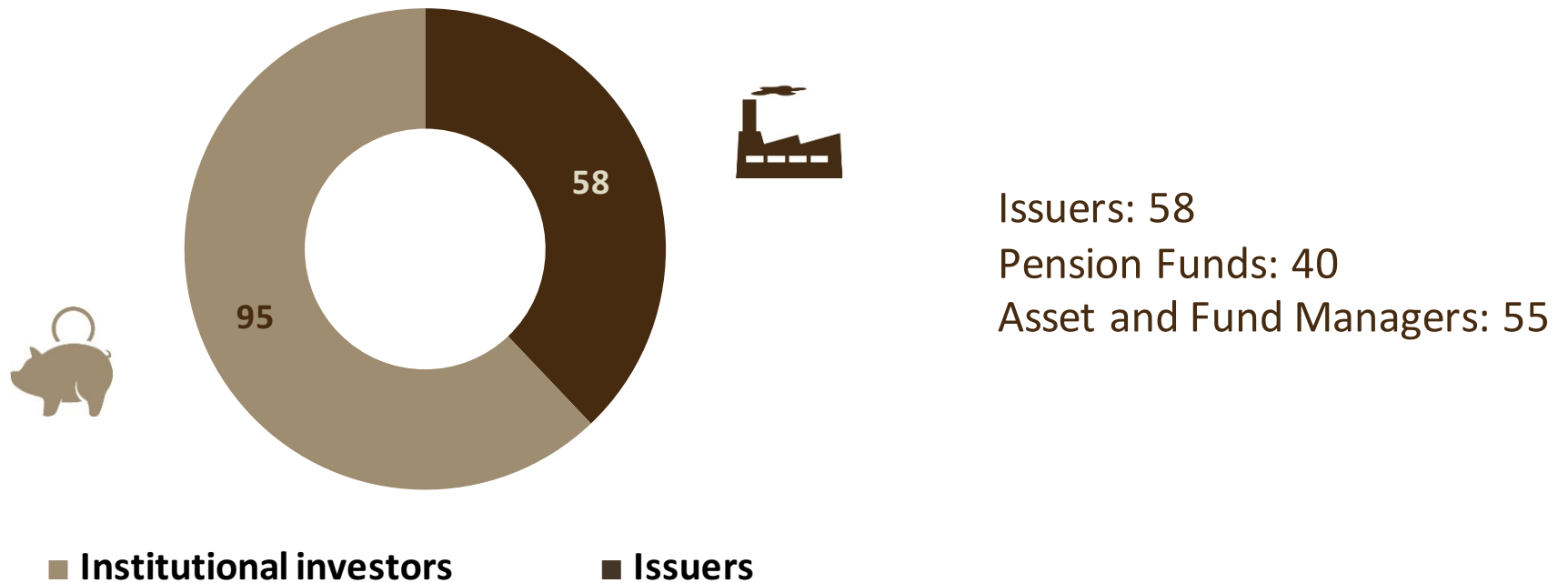


Plan for this presentation

- **Basic information on the survey**
- Key results
- Agenda items: relevance and effort
- Disclosure: quality and quantity
- Shareholder voting rights: benefits and costs
- Regulation: hopes and fears
- Summary and outlook



Participants

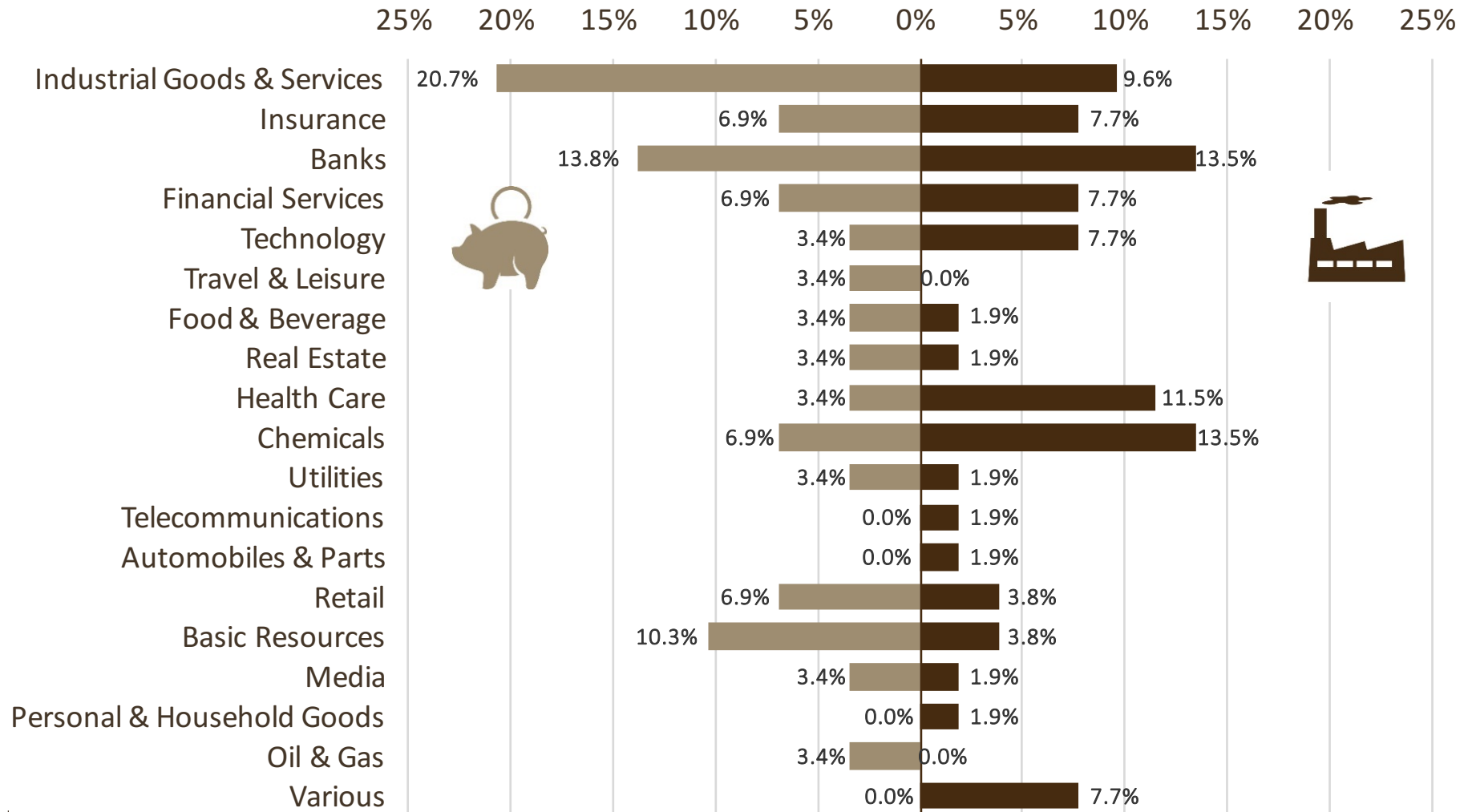


A total of 153 participants filled out the survey
(+ 41.7% compared to 2014)



Participating industries

Sample: pension funds and issuers only





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Key results (I/II)



➤ **Agenda items: relevance and effort**

- Items regarding compensation required the greatest effort from both issuers *and* investors, but are not considered as the most important drivers of shareholder value
- For all surveyed groups, the election of board members has the greatest relevance for shareholder value

➤ **Disclosure: quality and quantity**

- The surveyed investors are generally not looking for more information, but for more *relevant* information
- Investors and issuers are split on standardizing disclosure



Key results (II/II)



- **Shareholder voting rights: benefits and costs**
 - In contrast to asset managers, a substantial fraction of pension funds attest little value to voting rights
 - Issuers consider voting rights as a means for shareholders to express an opinion, with only limited influence on a firm's value creation

- **Regulation: hopes and fears**
 - Investors and issuers eye future regulatory efforts critically (e.g., regarding prospective voting regimes or compensation caps), and have different views on opting out provisions



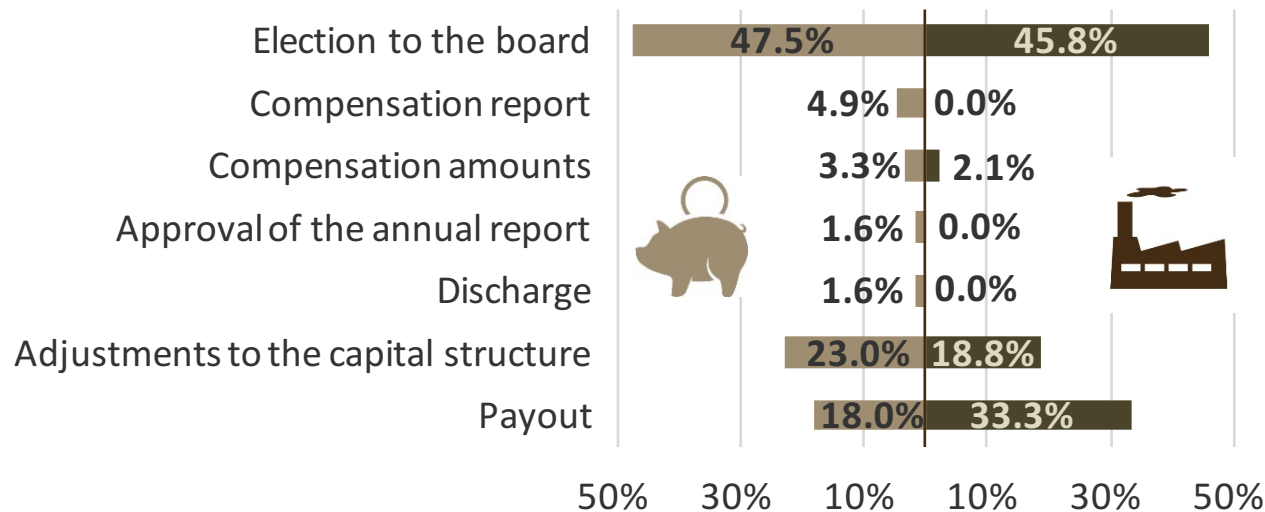
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Agenda items: relevance

Agenda items with the greatest relevance for a firm's value generation



| | Pension funds | CH asset managers | Int. asset managers |
|-------------------|---------------|-------------------|---------------------|
| Election to board | 40.6% | 50.0% | 63.6% |
| Comp. report | 3.1% | 5.6% | 9.1% |
| Comp. amounts | 6.3% | 0.0% | 0.0% |
| Approval AR | 0.0% | 5.6% | 0.0% |
| Discharge | 0.0% | 5.6% | 0.0% |
| Capital structure | 28.1% | 16.7% | 18.2% |
| Payout | 21.9% | 16.7% | 9.1% |

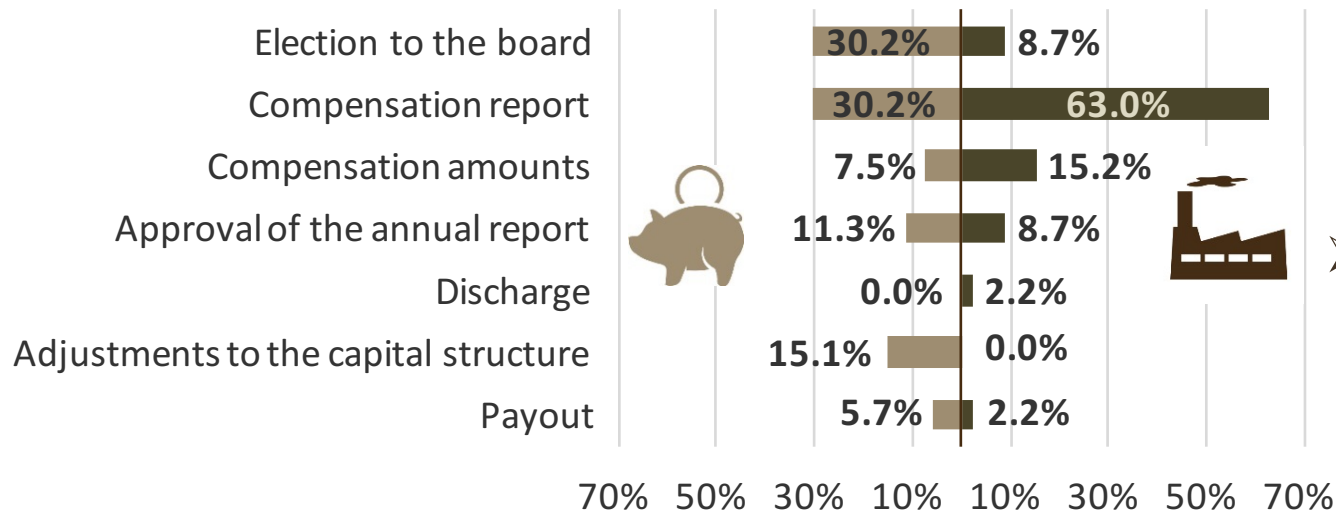
Question: Consider the following agenda items, which are subject to a shareholder vote at Swiss annual general meetings. In your opinion, which vote has the largest impact on the value generation of a company in general?

- Investors and issuers largely agree on the relevance of different agenda items for a firm's value creation
- Board elections are considered the most value-relevant agenda items
- In contrast, agenda items on compensation are of comparably little relevance



Agenda items: effort

Agenda items associated with the greatest preparation effort



➤ 38% of the investors and 78% of the issuers dedicated the highest effort to compensation items

➤ For investors, the preparation of board elections is comparable in exerted effort

| | Pension funds | CH asset managers | Int. asset managers |
|-------------------|---------------|-------------------|---------------------|
| Election to board | 25.0% | 42.1% | 20.0% |
| Comp. report | 37.5% | 21.1% | 30.0% |
| Comp. amounts | 4.2% | 5.3% | 20.0% |
| Approval AR | 16.7% | 10.5% | 0.0% |
| Discharge | 0.0% | 0.0% | 0.0% |
| Capital structure | 12.5% | 15.8% | 20.0% |
| Payout | 4.2% | 5.3% | 10.0% |

Question: Consider the following agenda items, which are subject to a shareholder vote at Swiss annual general meetings.
On which agenda item did you spend the most time in preparing the voting decision during the AGM season 2015?

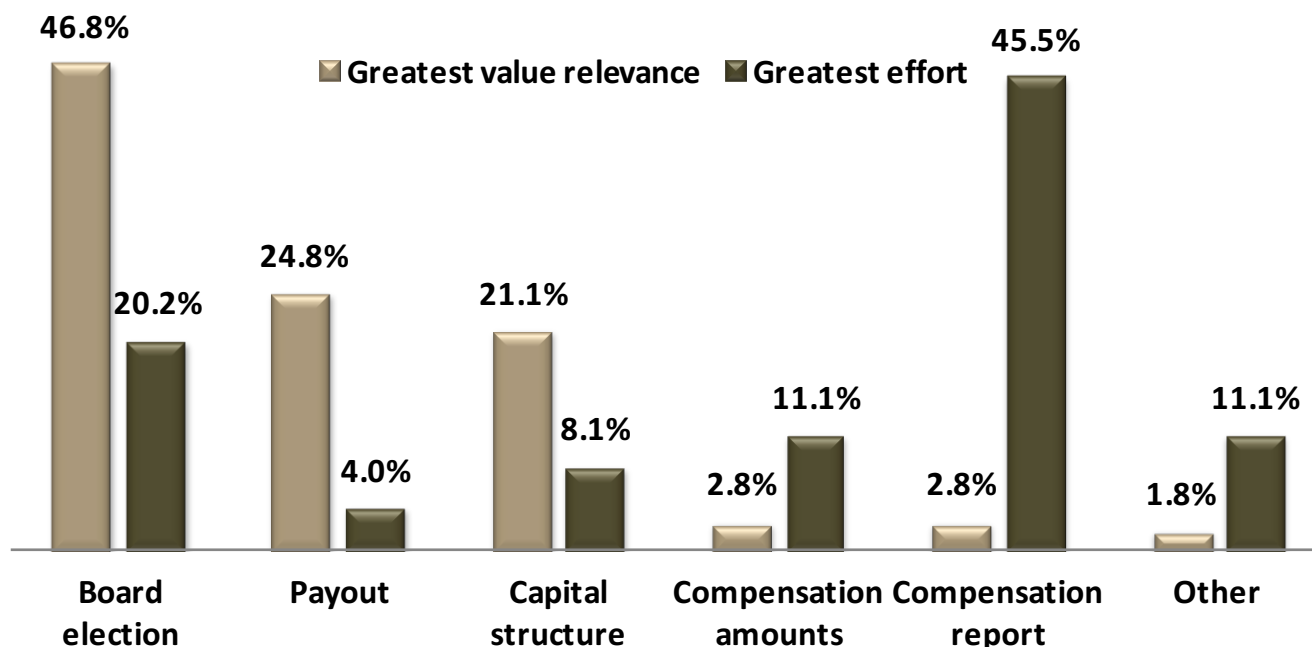


Agenda items: relevance vs. effort



Comparison of the agenda items' value generation relevance and preparation effort
Sample: investors and issuers pooled

Issuers and investors were surveyed on the agenda item with the greatest impact on value generation for a company (value relevance; 109 answers) and on the agenda item with the greatest effort requirement during the AGM season 2015 (effort; 99 answers).



- Large discrepancy between greatest effort and greatest perceived value relevance
- Careful interpretation: Question was about most important item (compensation may very well be seen as quite important)

Consider the following agenda items, which are subject to a shareholder vote at Swiss annual general meetings.
 Question regarding value generation: In your opinion, which vote has the largest impact on the value generation of a company in general?
 Question regarding effort: On which agenda item did you spend the most time in preparing the voting decision during the AGM season 2015?



Plan for this presentation

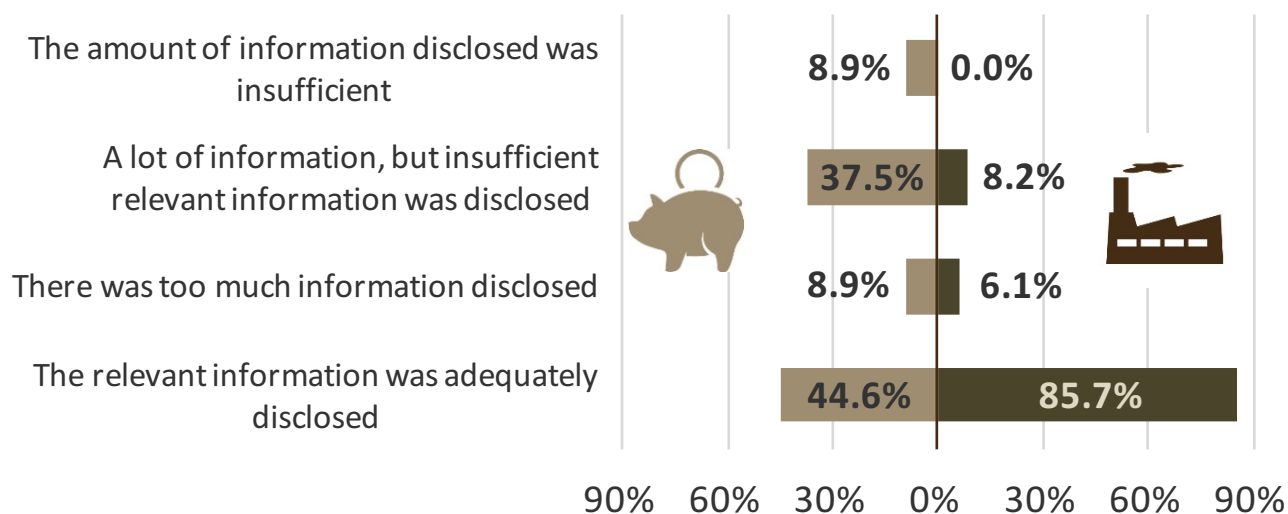
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Disclosure: quality vs. quantity



Relevance of disclosed information on compensation in general



- The effort on compensation items may be reduced by orienting disclosure more towards shareholders' needs
- Almost 50% of the investors look for more or more relevant information
- This perception largely remained unchanged compared to last year

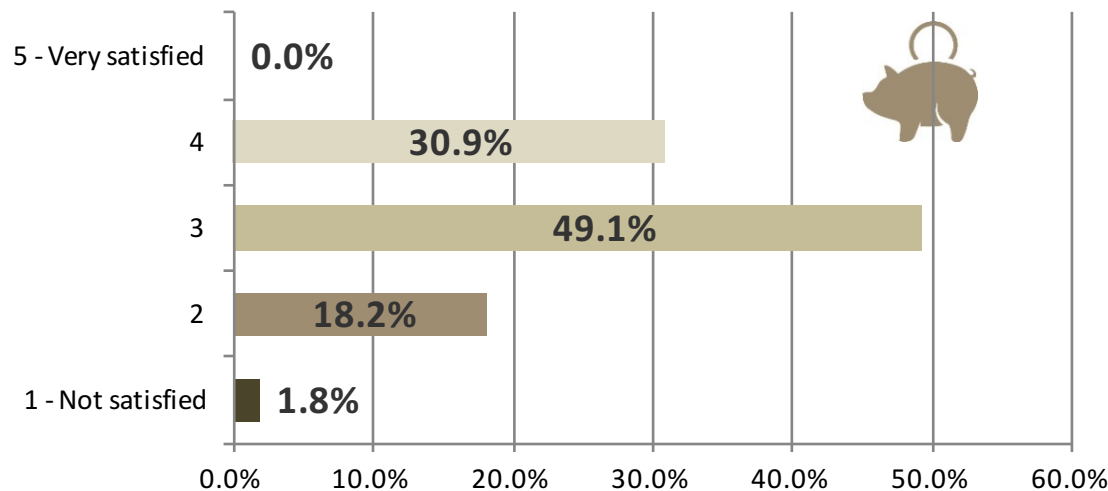
| | Pension funds | CH asset managers | Int. asset managers |
|--|---------------|-------------------|---------------------|
| The amount of information disclosed was insufficient | 9.4% | 0.0% | 25.0% |
| A lot of information, but insufficient relevant... | 37.5% | 25.0% | 62.5% |
| There was too much information disclosed | 12.5% | 6.3% | 0.0% |
| The relevant information was adequately disclosed | 40.6% | 68.8% | 12.5% |

Question: Some companies disclose comprehensive details in their compensation report, while other companies stick to the legal minimum requirements. How would you assess the general disclosure quality during the AGM season 2015?



Disclosure: traceability

Traceability of proposed compensation amounts
Sample: investors only



- Less than one third of the investors was actually satisfied with the disclosed information, no one was very satisfied
- Half of the investors are indifferent regarding the importance of the compensation information

| | Pension funds | CH asset managers | Int. asset managers |
|--------------------|---------------|-------------------|---------------------|
| 5 - Very satisfied | 0.0% | 0.0% | 0.0% |
| 4 | 34.5% | 43.8% | 0.0% |
| 3 | 55.2% | 37.5% | 44.4% |
| 2 | 10.3% | 18.8% | 44.4% |
| 1 - Not satisfied | 0.0% | 0.0% | 11.1% |

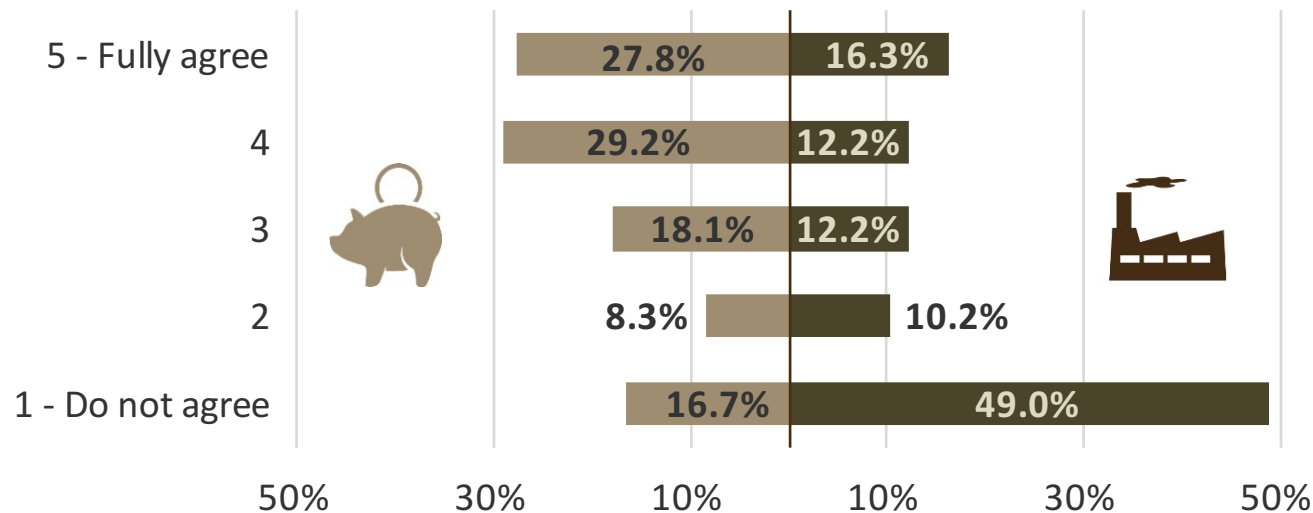
Question: How satisfied were you with the issuers' disclosure with respect to the traceability of the proposed compensation amounts during the AGM season 2015?



Disclosure: standardization



Standardization of compensation disclosure



- A standardized disclosure may be seen as facilitating the understanding of compensation systems
- A majority of investors favor a standardized disclosure, half of the issuers disagree

| | Pension funds | CH asset managers | Int. asset managers |
|------------------|---------------|-------------------|---------------------|
| 5 – Fully agree | 27.8% | 21.7% | 38.5% |
| 4 | 22.2% | 34.8% | 38.5% |
| 3 | 16.7% | 21.7% | 15.4% |
| 2 | 11.1% | 8.7% | 0.0% |
| 1 – Do not agree | 22.2% | 13.0% | 7.7% |

Question: How do you perceive the following trends in regulation related to corporate governance in Switzerland?
 Companies should adhere to a standardized reporting format for general disclosure requirements (for example in relation to compensation matters).



Implications: agenda items & disclosure

- A potential gap (inefficiency) between value relevance and effort exists for various agenda items, most prominently for compensation-related items
- There is, however, convincing evidence regarding the (empirical) relevance of compensation systems for corporate decisions and thus shareholder value
- Standardizing compensation disclosure is not a panacea
- SWIPRA: Providing a more relevant disclosure, in particular on pay-performance, reduces investors' effort and supports value generation internally
- SWIPRA: Board elections should be prepared and documented carefully by issuers



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Voting rights: benefits vs. costs

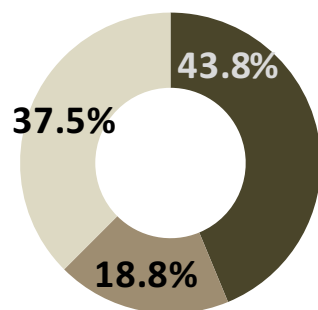


General value of shareholder voting rights for investors

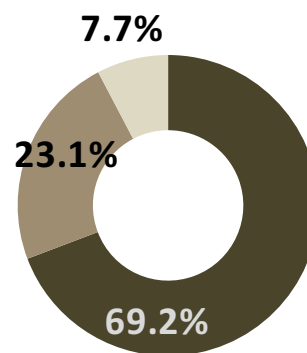
Sample: investors only

- Exercising voting rights may, overall, generate value in the medium term
- Costs and benefits of exercising voting rights are balanced
- Exercising voting rights is unnecessary

Pension funds



Asset managers



- Past regulation has considerably increased shareholder power
- Yet, more than one in three pension funds does not assign value to this
- By contrast, more than two thirds of asset and fund managers believe that exercising voting rights can generate value

| | CH asset managers | Int. asset managers |
|--|-------------------|---------------------|
| Exercising voting rights may, overall, generate value in the medium term | 56.3% | 90.0% |
| Costs and benefits of exercising voting rights are balanced | 31.3% | 10.0% |
| Exercising voting rights is unnecessary | 12.5% | 0.0% |

Question: In your opinion, what is the general value of shareholder voting rights for your organization?

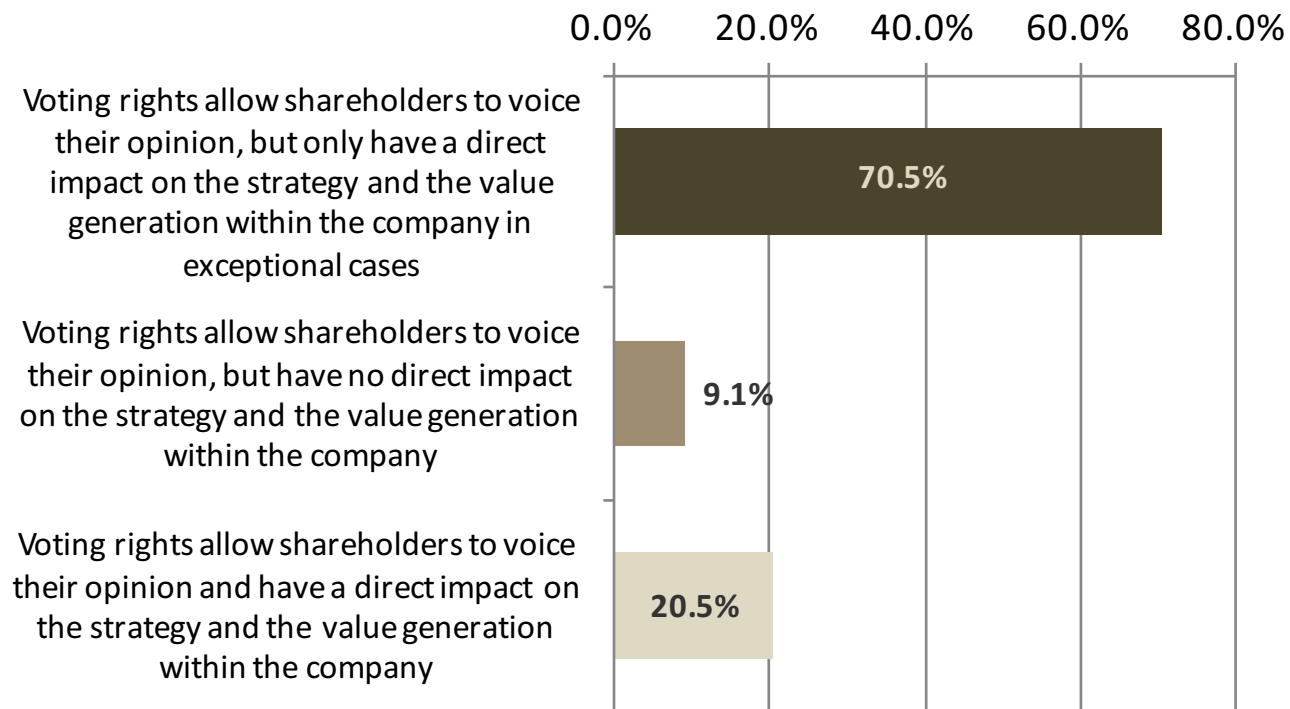


Voting rights: benefits vs. costs



General value of shareholder voting rights for issuers

Sample: issuers only



- A majority of issuers interpret shareholder votes as advice / opinions
- Only a minority actually believes that shareholder votes impact a company's value generation

Question: In your opinion, what is the general value of shareholder voting rights for the development of your company?



Implications: voting rights

- Disagreement regarding the value of shareholder voting rights
 - A substantial fraction of pension funds (a target group of the OaEC!) does not see an added value
 - Issuers see an advisory instead of a direct control function
- Surprising in light of
 - recent developments in Switzerland (e.g. SIKa, LafargeHolcim, etc.)
 - the vast amount of passive equity investments which only leave voting rights as a control measure (no voting by feet)
 - empirical research, which provides evidence that voting rights indeed have a value, particularly in exceptional circumstances
- SWIPRA: Voting rights carry value which should be used in direct and indirect investments



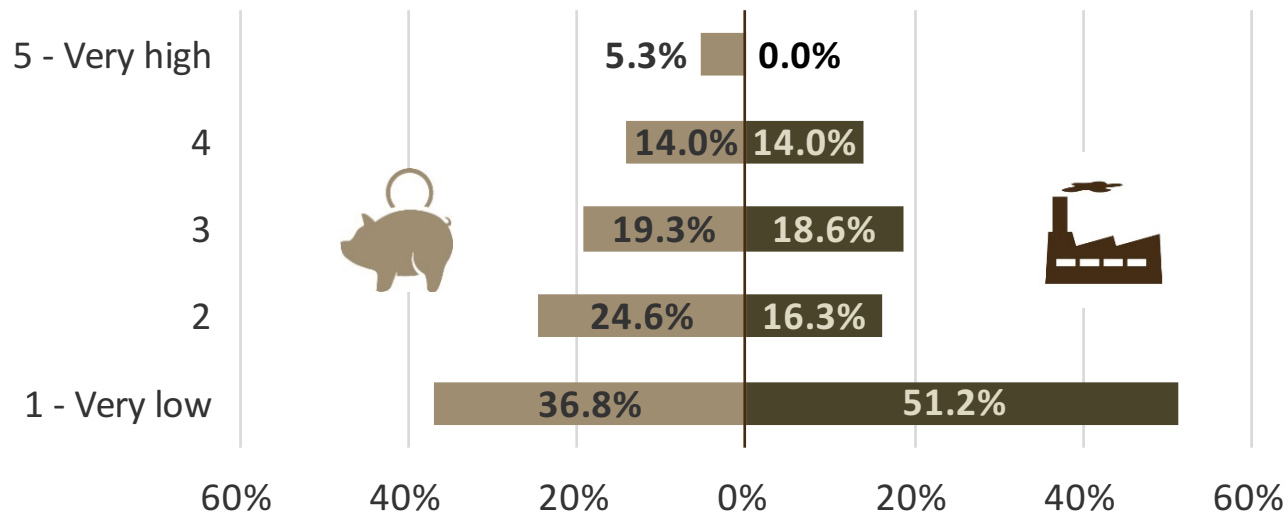
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Regulation: OaEC impact

Balance between positive aspects and implementation costs of the OaEC



- The majority of investors and issuers do not expect the OaEC to have a positive net effect
- By contrast, over 40% of international asset managers think that the OaEC's positive effects outweigh the implementation costs
- Concerns in particular regarding pay-for-performance impact (see additional results)

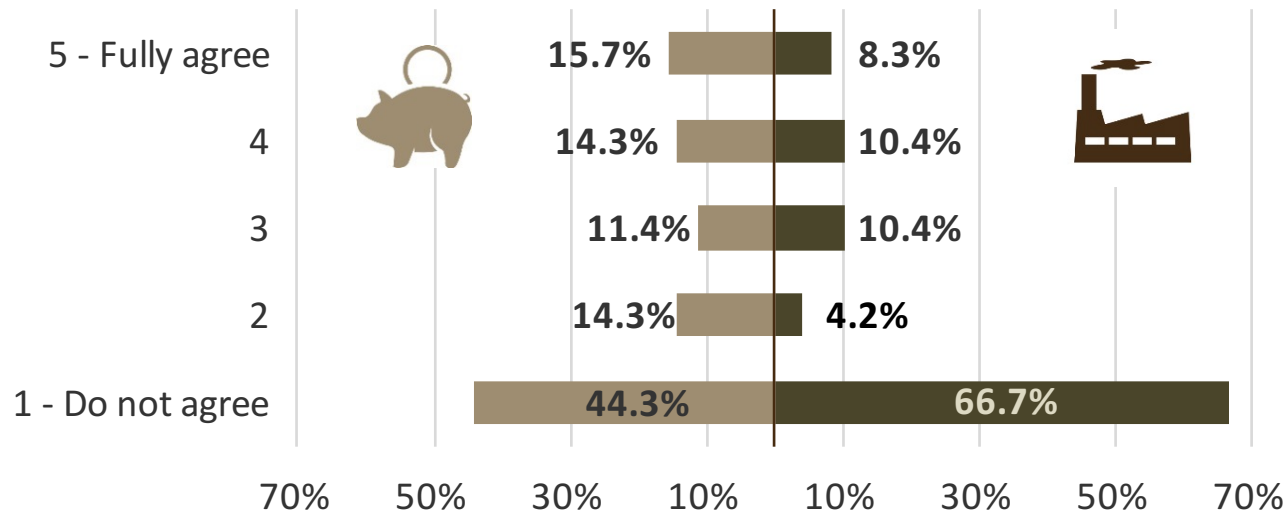
Question: In your opinion, what is the likelihood that the positive aspects of the OaEC outweigh the implementation costs of the OaEC for your organization?



Regulation: current issues



Only retrospective (ex-post) votes on performance-based compensation should be allowed



- The majority of investors and issuers does not see a need to restrict prospective voting regimes
- 30% of investors, mainly driven by pension funds, think that only retrospective votes should be allowed

| | Pension funds | CH asset managers | Int. asset managers |
|------------------|---------------|-------------------|---------------------|
| 5 – Fully agree | 16.7% | 17.4% | 9.1% |
| 4 | 16.7% | 8.7% | 18.2% |
| 3 | 8.3% | 4.3% | 36.4% |
| 2 | 13.9% | 21.7% | 0.0% |
| 1 – Do not agree | 44.4% | 47.8% | 36.4% |

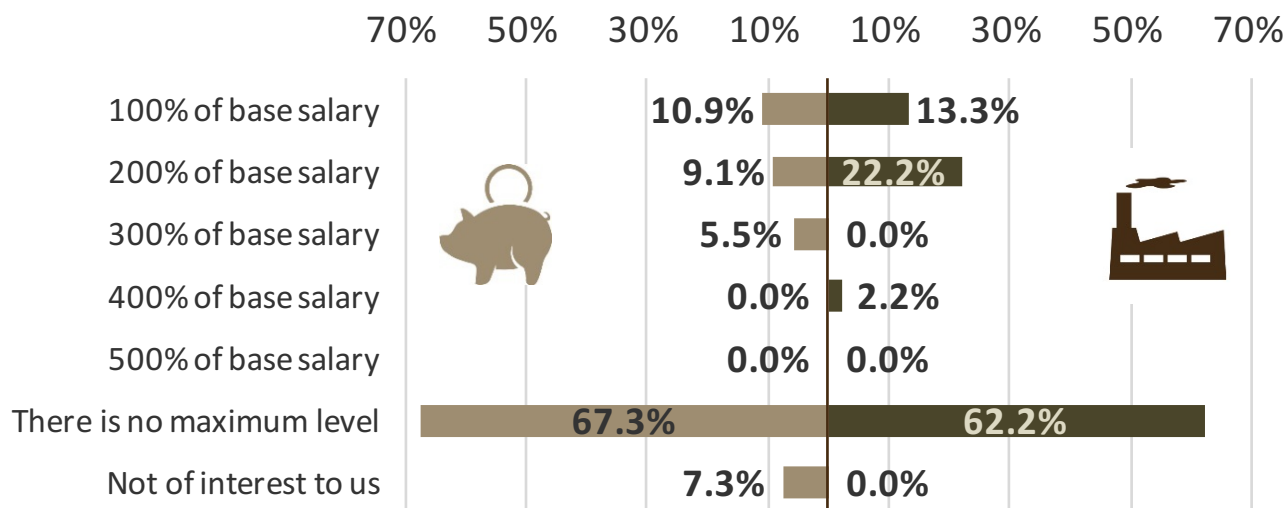
Question: How do you perceive the following trends in regulation related to corporate governance in Switzerland?
 Votes on compensation amounts should be further regulated to allow only retrospective (ex-post) votes on performance-based compensation.



Regulation: current issues



Cap on individual cash-bonus payments



- The vast majority of investors and issuers is against caps on cash-bonus payments
- However, all participants share the opinion that cash-bonus payments need to be linked to the company's performance

| | Pension funds | CH asset managers | Int. asset managers |
|---------------------------|---------------|-------------------|---------------------|
| Not of interest to us | 6.5% | 11.8% | 0.0% |
| There is no maximum level | 61.3% | 76.5% | 71.4% |
| 500% of base | 0.0% | 0.0% | 0.0% |
| 400% of base | 0.0% | 0.0% | 0.0% |
| 300% of base | 9.7% | 0.0% | 0.0% |
| 200% of base | 12.9% | 5.9% | 0.0% |
| 100% of base | 9.7% | 5.9% | 28.6% |

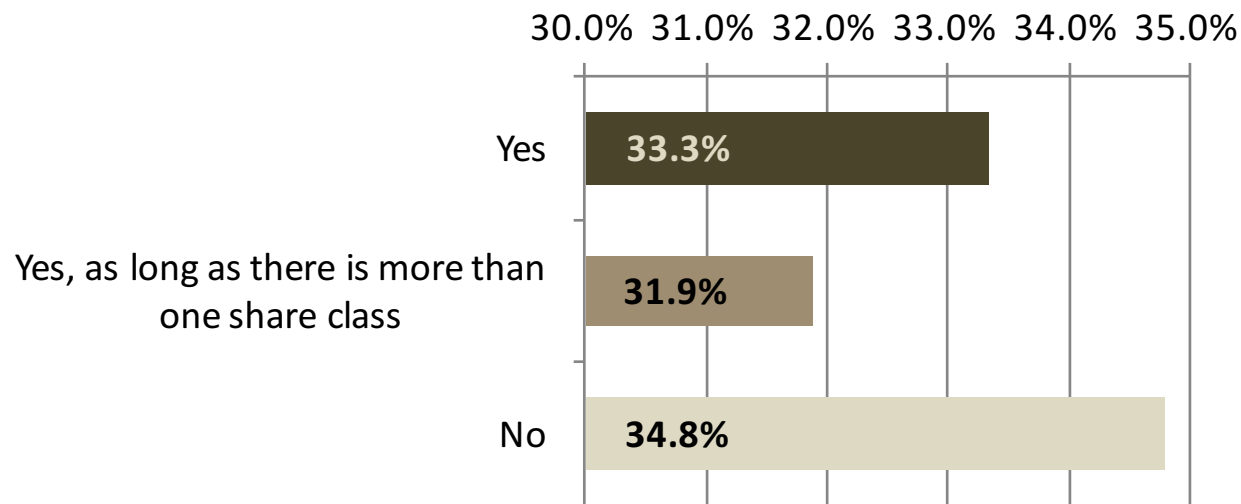
Question: In your opinion, what should be the maximum for individual cash-bonus payments?



Regulation: current issues



„Opting-out“-provisions
Sample: investors only



- The majority of investors (65.2%) supports a cancellation of opting-out provisions for companies with a dual-class share structure
- A substantial part of investors, especially international asset and fund managers (76.9%), supports a general abolishment

| | Pension funds | CH asset managers | Int. asset managers |
|--|---------------|-------------------|---------------------|
| Yes | 26.5% | 18.2% | 76.9% |
| Yes, as long as there is more than one share class | 35.3% | 40.9% | 7.7% |
| No | 38.2% | 40.9% | 15.4% |

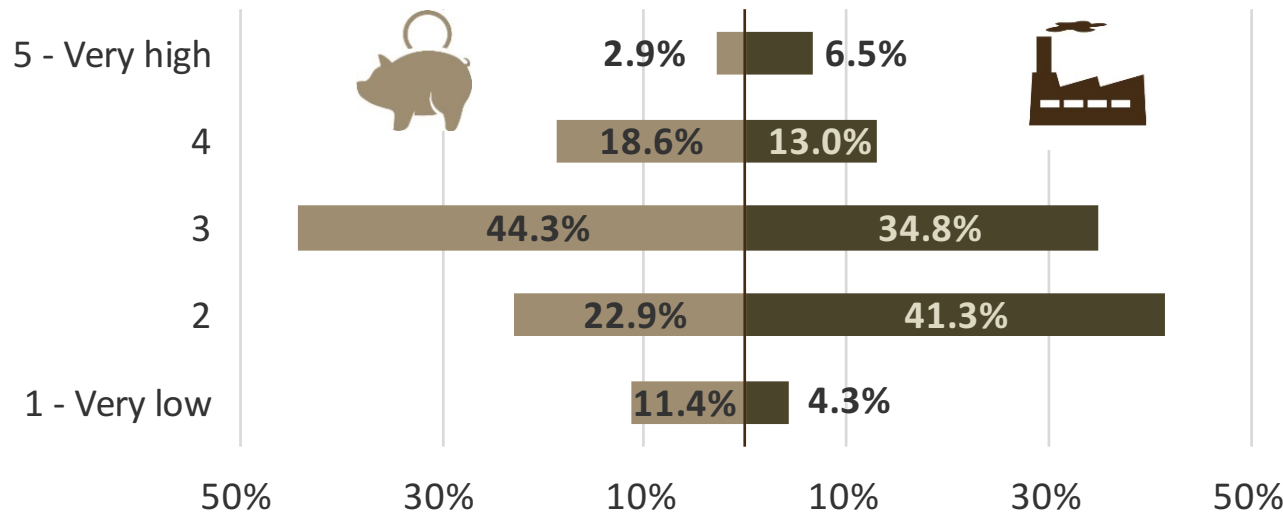
Question: „Opting-out“-provisions (an acquirer of a large block of shares (e.g., 33 1/3% of the shares outstanding) is not obliged to provide a purchase offer with similar terms to all shareholders) should be prohibited.



Regulation: hopes and fears



Congruence between future regulation and own preferences



- Only one fifth of all surveyed participants expect future regulation to be in their interest
- Issuers are generally more pessimistic than investors regarding the effects of further regulation

| | Pension funds | CH asset managers | Int. asset managers |
|---------------|---------------|-------------------|---------------------|
| 5 – Very high | 2.9% | 4.3% | 0.0% |
| 4 | 8.6% | 26.1% | 33.3% |
| 3 | 54.3% | 34.8% | 33.3% |
| 2 | 22.9% | 21.7% | 25.0% |
| 1 – Very low | 11.4% | 13.0% | 8.3% |

Question: Consider again the previously raised regulation topics. In your opinion, what is the probability that your overall preferences with regards to an increase / decrease in regulation will be realized?



Implications: regulation

- Investors and issuers generally have a clear view on several currently discussed legal and regulatory developments:
 - Prospective voting regimes should not be restricted
 - Bonus caps should not be made mandatory
 - Opting-out provisions should be abolished from the investors' point of view; this contrasts with the issuers' opinion
- A majority of the participants believes that overall the OaEC induced more costs than provided benefits, and they worry about costs and benefits of future laws and regulations
- SWIPRA believes that regulation and legal developments should also be guided by economic considerations, weighing benefits and costs for different types of companies



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Summary and outlook

- This survey presents a unique view on the opinions of both institutional investors and issuers
- Recent corporate governance rules and regulations have arguably led to some inefficiencies (relevance-effort gap)
- Market participants want lawmakers and regulators to tread carefully when considering further extensions of regulation
- For market discipline to work, it is crucial that shareholders make use of the rights they already have



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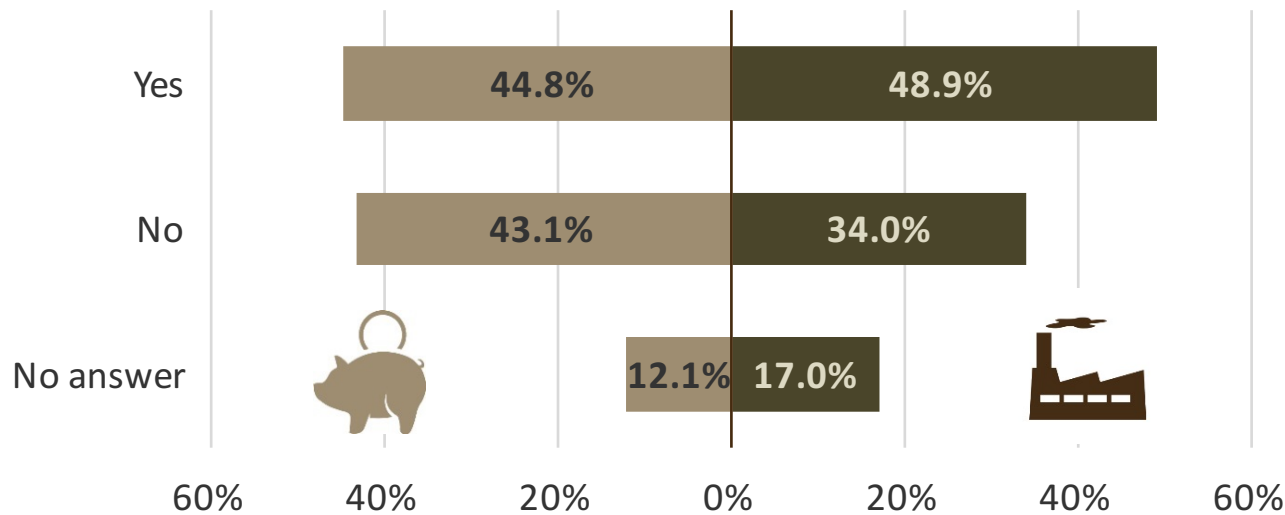
Appendix

- further results -



Board: CEO appointment

Board candidate is CEO of the same company



- Almost 50% of all participants believe that a company's CEO should not be a member of the board
- This is only true for 20% of international asset managers

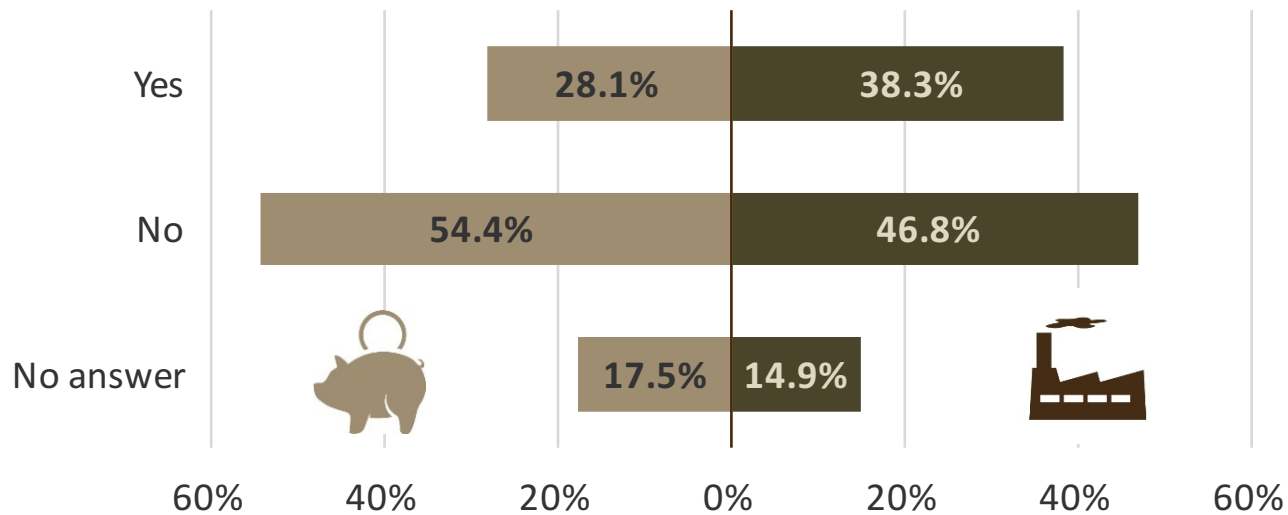
| | Pension funds | CH asset managers | Int. asset managers |
|-----------|---------------|-------------------|---------------------|
| Yes | 46.9% | 56.3% | 20.0% |
| No | 43.8% | 25.0% | 70.0% |
| No Answer | 9.4% | 18.8% | 10.0% |

Question: Which of the following criteria would you, in general, classify as exclusion criterion to become/stay member of the board of directors?
Candidate is CEO of the same company.



Board: age

Age of the board candidate



- A majority of all participants do not consider the age of a board member as exclusion restriction, almost 40% of issuers do
- For 90% of international asset managers, age is not an exclusion criterion

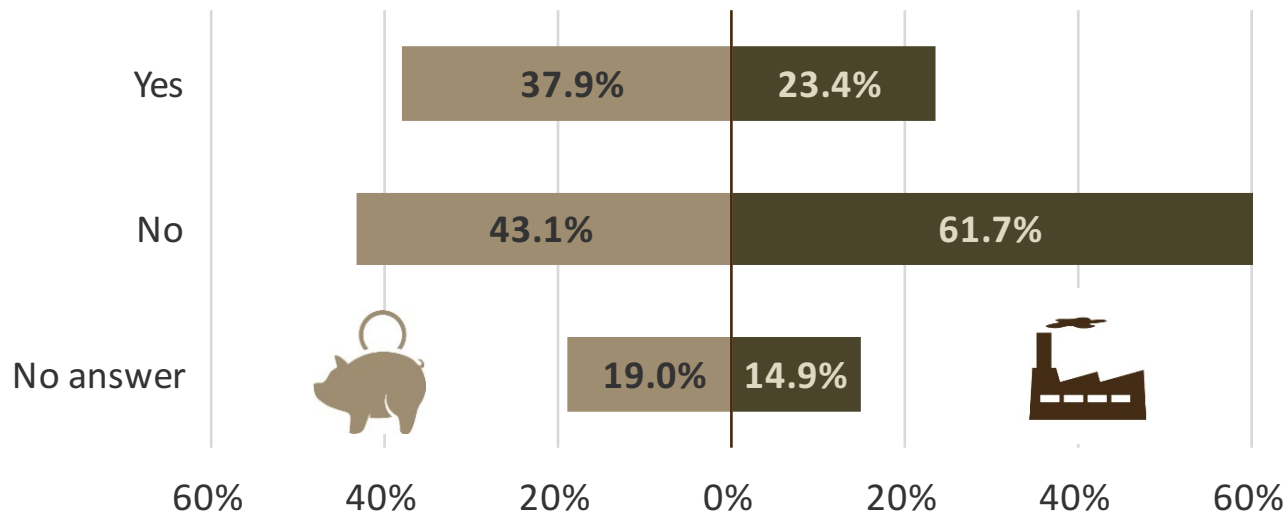
| | Pension funds | CH asset managers | Int. asset managers |
|-----------|---------------|-------------------|---------------------|
| Yes | 32.3% | 37.5% | 0.0% |
| No | 45.2% | 50.0% | 90.0% |
| No Answer | 22.6% | 12.5% | 10.0% |

Question: Which of the following criteria would you, in general, classify as exclusion criterion to become/stay member of the board of directors?
Candidate is too old.



Board: tenure

Board tenure of the candidate



- A majority of issuers and pension funds do not view long board tenure as a restriction for re-election
- All other investor groups, particularly international asset managers, are more critical regarding this issue

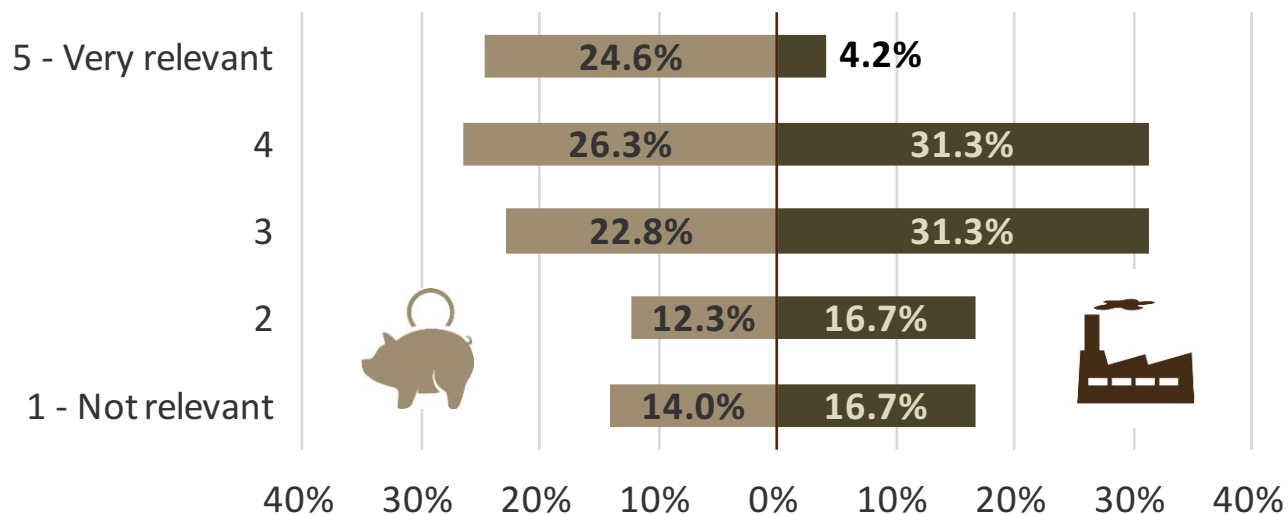
| | Pension funds | CH asset managers | Int. asset managers |
|-----------|---------------|-------------------|---------------------|
| Yes | 28.1% | 43.8% | 60.0% |
| No | 53.1% | 31.3% | 30.0% |
| No Answer | 18.8% | 25.0% | 10.0% |

Question: Which of the following criteria would you, in general, classify as exclusion criterion to become/stay member of the board of directors?
Excessive board tenure of the candidate.



Disclosure: pay-for-performance

Quality of disclosed information regarding pay-for-performance



- The disclosure on pay for performance is considered (very) relevant by all investors
- Only a third of the issuers agree with this
- Despite increased attention on compensation, tension between investors and issuers has remained unchanged to last year

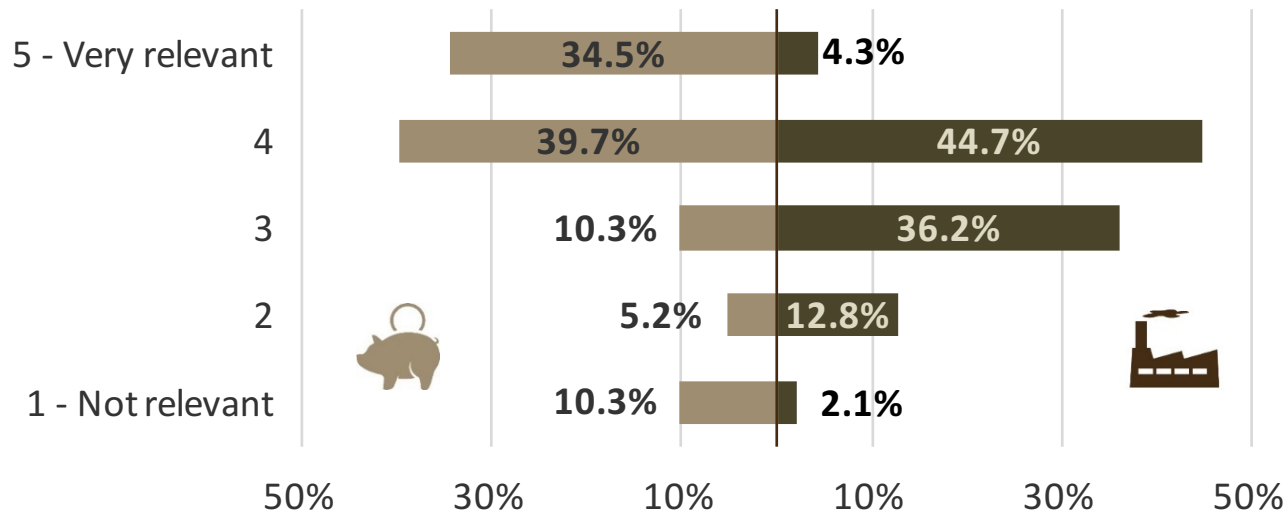
| | Pension funds | CH asset managers | Int. asset managers |
|-------------------|---------------|-------------------|---------------------|
| 5 - Very relevant | 23.3% | 0.0% | 70.0% |
| 4 | 26.7% | 29.4% | 20.0% |
| 3 | 26.7% | 23.5% | 10.0% |
| 2 | 10.0% | 23.5% | 0.0% |
| 1 - Not relevant | 13.3% | 23.5% | 0.0% |

Question: Certain companies publish the following items in detail in their compensation reports. How relevant are, in your opinion, these items?
A comparison between the achievement levels of the compensation relevant performance targets for the executives, and the highest paid executive in particular, and the resulting payout of variable compensation elements for the past business year.



Disclosure: LTI payout

Retrospective disclosure of effectively paid long-term compensation



- For investors, the retrospective disclosure of long-term performance-based compensation is (very) important
- Less than 50% of the issuers share this view
- Important in future periods?

| | Pension funds | CH asset managers | Int. asset managers |
|-------------------|---------------|-------------------|---------------------|
| 5 - Very relevant | 35.5% | 23.5% | 50.0% |
| 4 | 29.0% | 58.8% | 40.0% |
| 3 | 16.1% | 0.0% | 10.0% |
| 2 | 3.2% | 11.8% | 0.0% |
| 1 - Not relevant | 16.1% | 5.9% | 0.0% |

Question: In your opinion, how relevant is a retrospective disclosure of the effectively paid compensation from long-term performance-based remuneration plans (actual expenses for the company)?

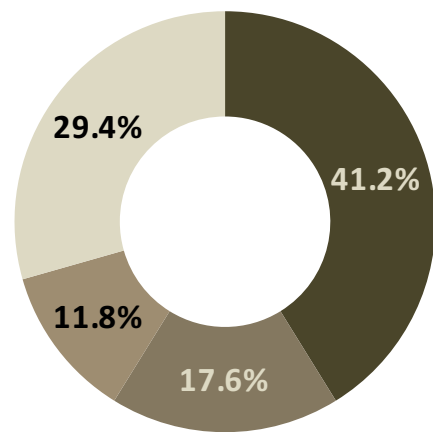


Voting rights: use

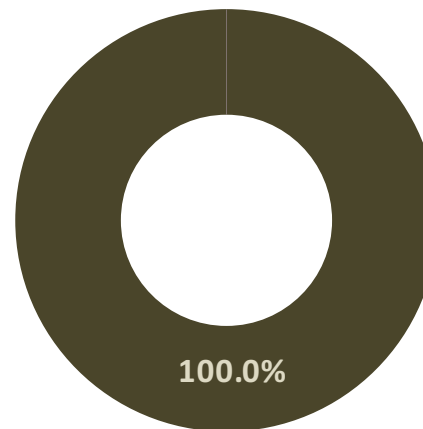
Possibility to actively use voting rights of (fund-) holdings

Sample: asset manager only

Asset managers (CH)



Asset managers (int.)



- Yes, on all (fund) holdings
- Yes, but only on (fund) holdings in Swiss securities
- Yes, but only for actively managed (fund) holdings
- No

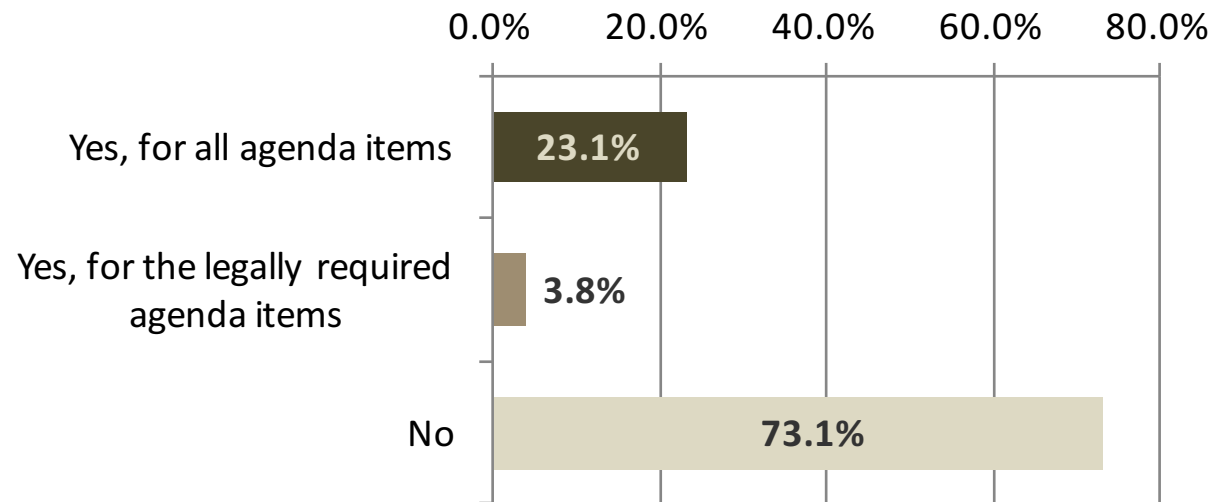
- All international asset managers actively use their voting rights
- By contrast, almost a third of the Swiss asset managers make no use of their voting rights

Question: Does your asset management company actively use the voting rights of its (fund) holdings in equity positions Switzerland?



Voting rights

Active use of voting rights for indirect investments after OaEC
Sample: pension funds only



- One fourth of pension funds make use of their voting rights also in indirect investments
- In 2014, 30% of the responding pension funds planned to use voting rights in indirect investments

Question: Does your organization generally actively use its voting rights (equity positions Switzerland) for indirect investments at general meetings (i.e., abstention from voting is the exception)?

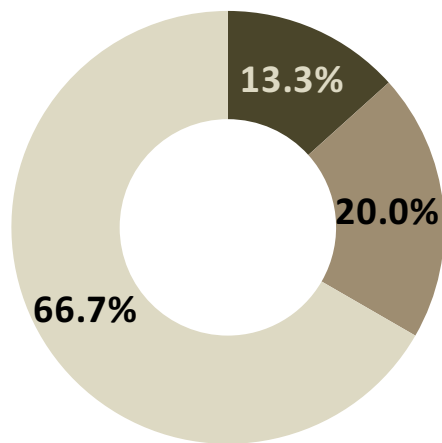


Voting rights

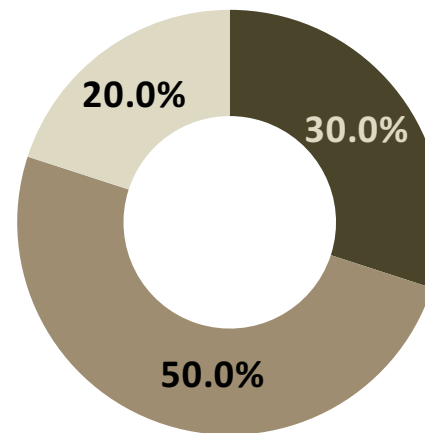
Possibility to actively use voting rights of (fund-) holdings

Sample: asset manager only

Asset managers (CH)



Asset managers (int.)



- Yes, this service is typically offered
- Yes, this service is offered at the client's request
- No

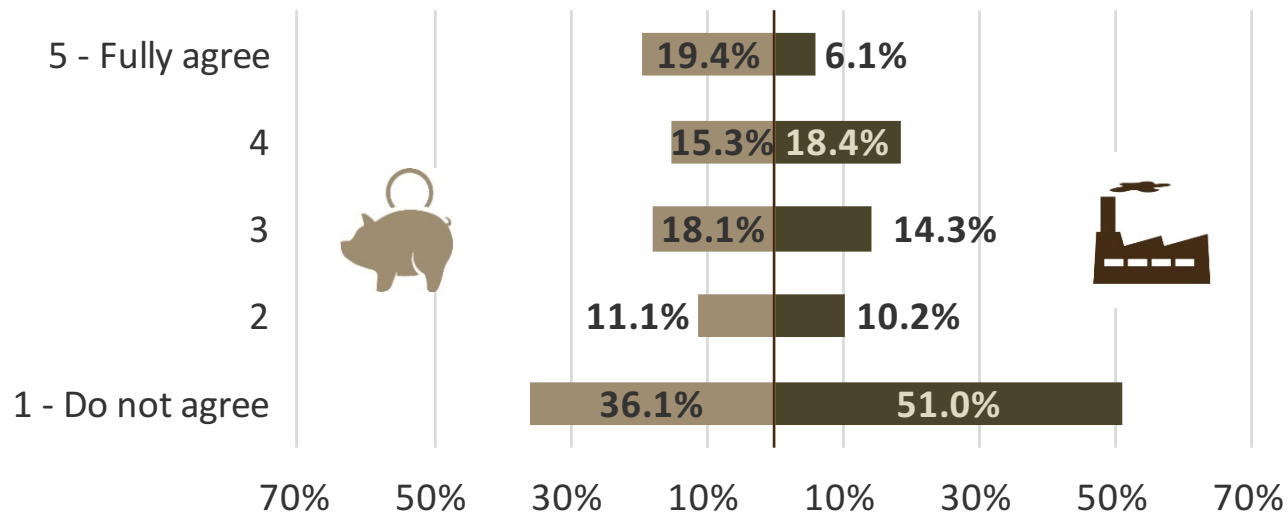
- Two thirds of domestic asset managers do not offer their clients the possibility to use voting rights
- Four out of five large international asset managers offer their clients the possibility to use voting rights

Question: Does your asset management offer its clients the possibility to actively use the voting rights of their (fund) holdings in equity positions Switzerland?



Voting rights

Requirement for all Swiss institutional investors to actively use shareholder voting rights



- About half of the issuers and pension funds share the opinion that asset managers should not be required to actively use their shareholder voting rights
- Interestingly, one third of the asset managers supports such a requirement

| | Pension funds | CH asset managers | Int. asset managers |
|------------------|---------------|-------------------|---------------------|
| 5 – Fully agree | 16.7% | 26.1% | 15.4% |
| 4 | 8.3% | 13.0% | 38.5% |
| 3 | 22.2% | 13.0% | 15.4% |
| 2 | 11.1% | 8.7% | 15.4% |
| 1 – Do not agree | 41.7% | 39.1% | 15.4% |

Question: How do you perceive the following trends in regulation related to corporate governance in Switzerland?
 In addition to Swiss pension funds, Swiss asset and fund managers should be legally required to actively make use of their voting rights in Swiss companies.

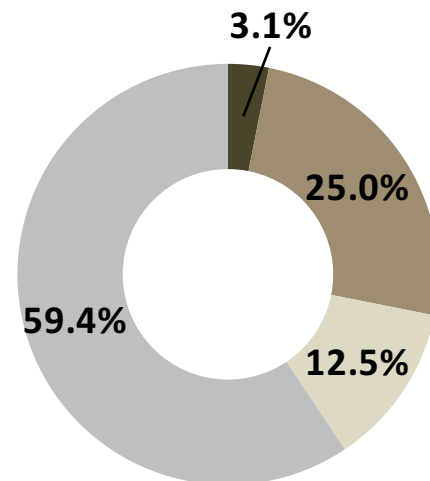


Voting rights

Preferences regarding the possibility to actively use voting rights for indirect investments
Sample: pension funds only

- About three out of ten pension funds believe that it is important for asset managers to offer the possibility to actively use voting rights on indirect investments

Pension funds



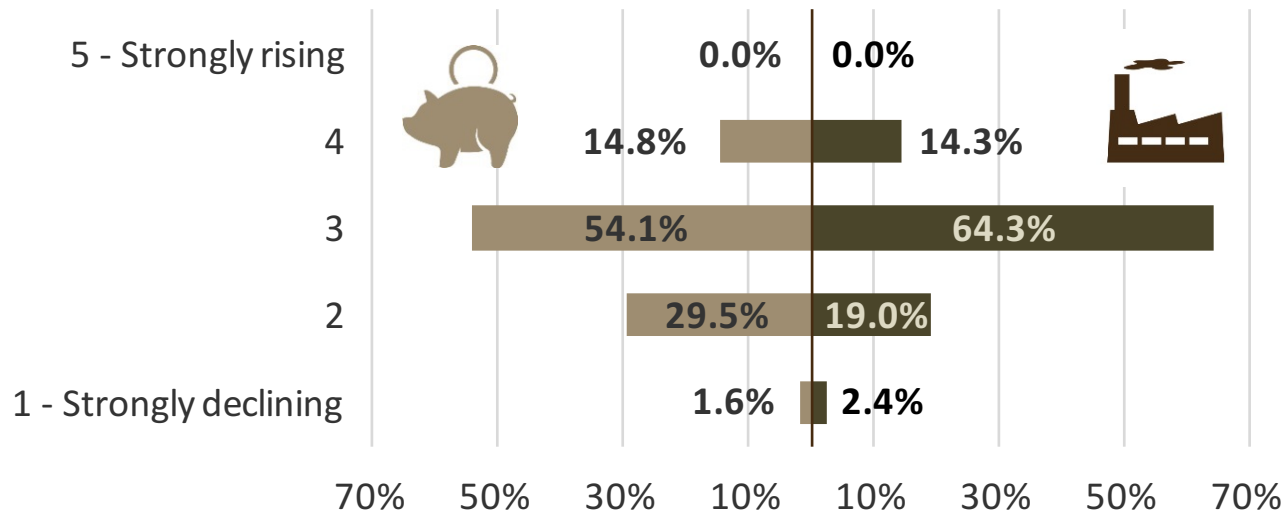
- Yes, very strong preference
- Yes, if possible
- Not relevant as our organization does not hold indirect investments
- No

Question: Would your organization prefer that external asset and fund managers provide you with the possibility to actively use your voting rights (equity positions Switzerland) also for indirect investments?



Regulation: OaEC impact

Impact of OaEC on management compensation



- The majority of the participants does not see an impact of the OaEC on management compensation
- Tendency in beliefs, mainly driven by Swiss organizations, towards a decline in compensation
- International asset managers do not expect a decline

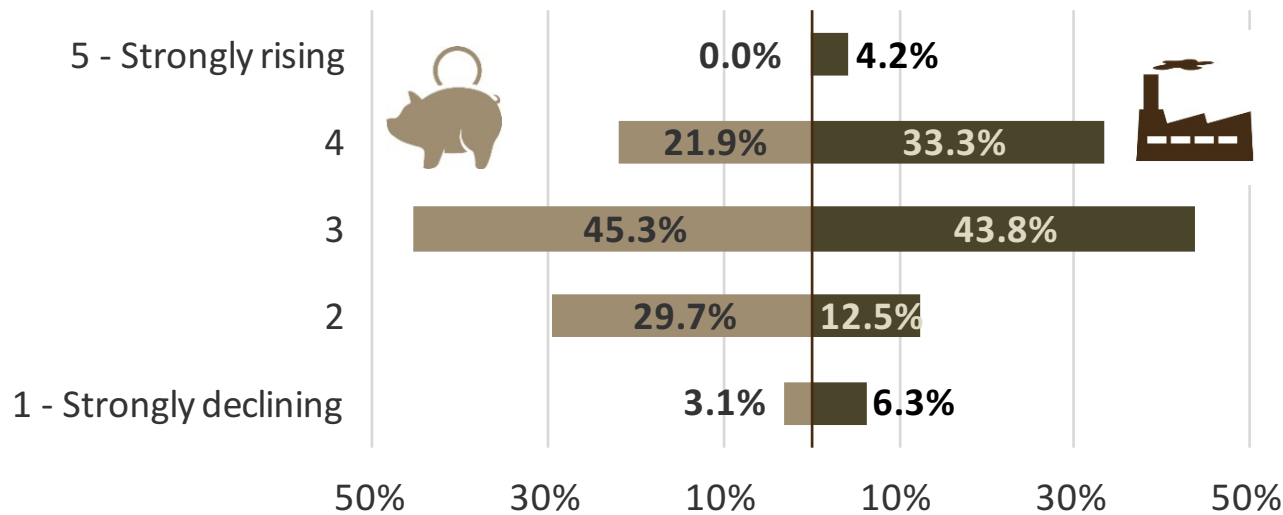
| | Pension funds | CH asset managers | Int. asset managers |
|------------------------|---------------|-------------------|---------------------|
| 5 – Strongly rising | 0.0% | 0.0% | 0.0% |
| 4 | 12.9% | 10.5% | 27.3% |
| 3 | 51.6% | 47.4% | 72.7% |
| 2 | 32.3% | 42.1% | 0.0% |
| 1 – Strongly declining | 3.2% | 0.0% | 0.0% |

Question: In your opinion, what are the consequences of the “Minder”-Initiative and the Ordinance against Excessive Compensation (OaEC) on following topics: management compensation?



Regulation: OaEC impact

Impact of OaEC on pay for performance



- Almost half of the respondents do not see an effect of the OaEC on pay for performance
- A third of the issuers expects a better alignment between performance and compensation
- Fewer investors share this view, especially fewer Swiss asset managers

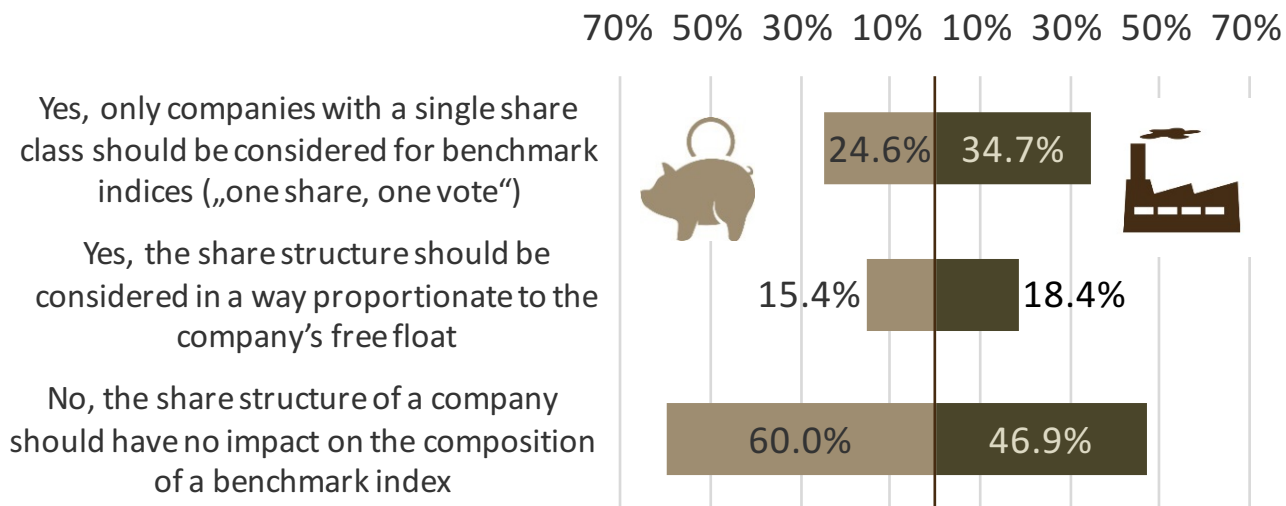
| | Pension funds | CH asset managers | Int. asset managers |
|------------------------|---------------|-------------------|---------------------|
| 5 – Strongly rising | 0.0% | 0.0% | 0.0% |
| 4 | 29.4% | 5.3% | 27.3% |
| 3 | 35.3% | 57.9% | 54.5% |
| 2 | 29.4% | 36.8% | 18.2% |
| 1 – Strongly declining | 5.9% | 0.0% | 0.0% |

Question: In your opinion, what are the consequences of the “Minder”-Initiative and the Ordinance against Excessive Compensation (OaEC) on following topics:
Alignment of performance and bonus (performance-related compensation) in executive compensation (pay for performance)?



Regulation: current issues

Securities selection for benchmark indices



- The majority of investors believes that a company’s share structure should have no impact on whether the company is included in an index
- In the case of issuers the opposite is true, though the difference is moderate

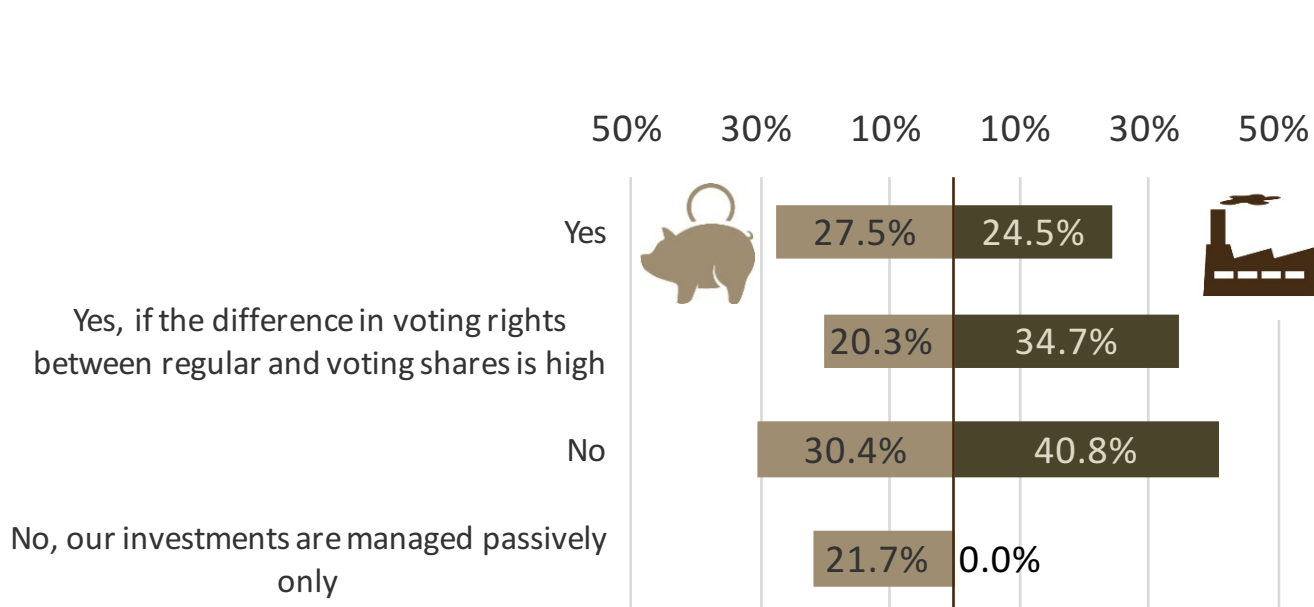
| | Pension Funds | CH Asset Managers | Int. Asset Managers |
|---|---------------|-------------------|---------------------|
| Yes, only companies with a single share class should be considered.. | 20.6% | 25.0% | 36.4% |
| Yes, the share structure should be considered in a way proportionate... | 8.8% | 30.0% | 9.1% |
| No, the share structure of a company ... | 70.6% | 45.0% | 54.5% |

Question: Should the securities selection for benchmark indices (e.g., SMI/SPI) consider, besides market capitalization and stock liquidity, the share structure (voting shares, participation capital, etc.) of a company?



Regulation: current issues

Impact of share structure for companies and investors



➤ Close to 60% of issuers believe that their share structure has an impact on the composition of their shareholder base

➤ While over 90% of the international asset managers consider a company's share structure when investing, only one quarter of pension funds does so

| | Pension funds | CH asset managers | Int. asset managers |
|---|---------------|-------------------|---------------------|
| Yes | 16.7% | 33.3% | 50.0% |
| Yes, if the difference in voting rights ... | 8.3% | 28.6% | 41.7% |
| No | 38.9% | 28.6% | 8.3% |
| No, our investments are managed.... | 36.1% | 9.5% | 0.0% |

Question: Do you consider the share structure of a company in your investment decision? (e.g., whether a company has a single share class or voting shares)?