



Governance Activism

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The Increasing Importance of Corporate Governance in Fund Managers' Decision Making

SWIPRA Corporate Governance Survey 2017

Zurich, November 8, 2017



SWIPRA Corporate Governance Survey 2017

- Scientifically-founded market analysis of investors' and corporate issuers' views over five years
- In cooperation with researchers at the DBF (UZH)
- 5th SWIPRA Corporate Governance Survey
 - SPI[®] companies representing approx. 80% of total index market cap
 - Swiss and international institutional investors, representing approx. EUR 13.1tn assets under management or approx. 20% of global equity investments



SWIPRA Corporate Governance Survey 2017

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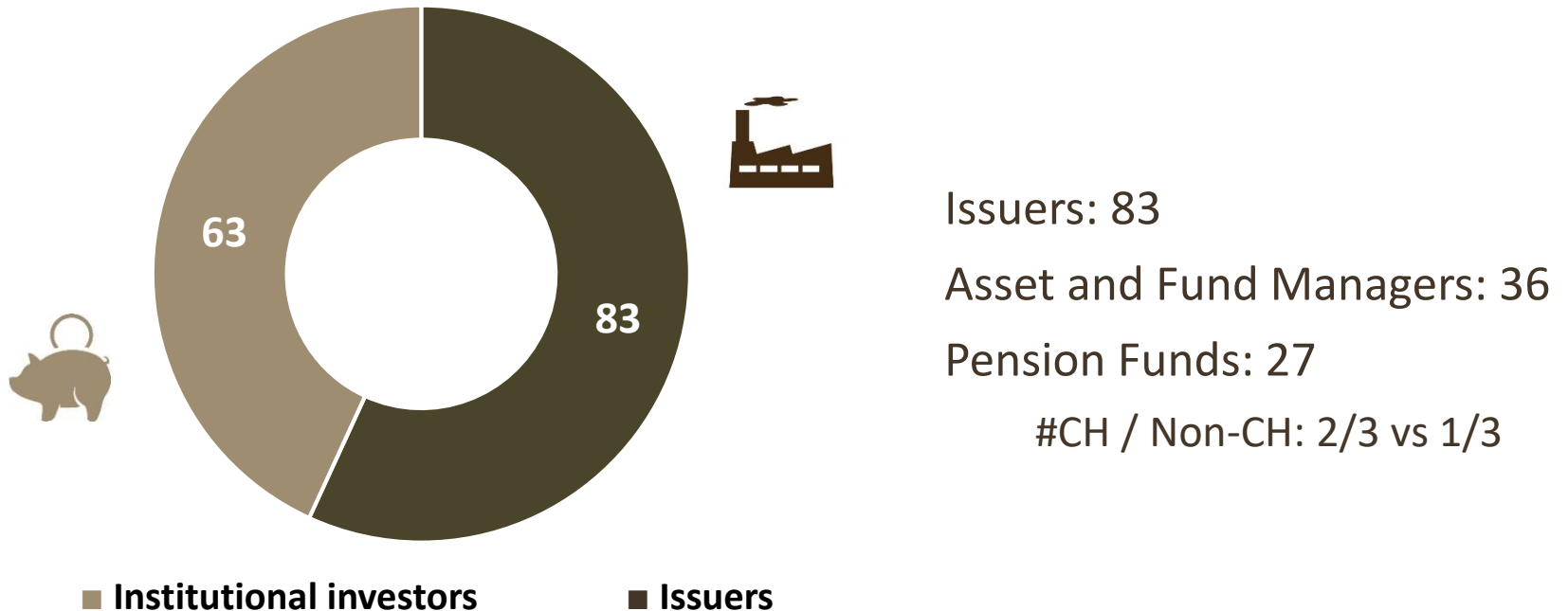


Plan for this presentation

- **General information on the survey**
- Key results
- Engagements: basis for governance activism
- Compensation votes: changing perception of binding votes
- Compensation disclosure: continued dissatisfaction
- CSR: expectations and responsibility of the board
- Audit topics: extending reach
- Summary and outlook



Participants 2017 SWIPRA Survey



A total of 146 participants filled out the survey, representing 79.3% of the SPI market cap and 20.8% of global equity AuM.



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Key results (I/II)



➤ **Engagements: basis for governance activism**

- Investor engagements considerably shape issuers' governance frameworks
- Relevant and decisive dialog regarding a company's governance framework is held during the year
- Interacting directly with investors on governance topics allows to promote the individual situation of the company and counters a standardized tick the box assessment

➤ **Votes on compensation amounts: changing perceptions**

- Shareholders are considering the binding votes on compensation amounts as their most important instrument to reinforce their views of a company's compensation framework, an important change in view
- The expected negative impact on a company's share price from a rejected vote on compensation amounts is small, but substantially higher than a rejected non-binding vote on the compensation report



Key results (II/II)



- **Compensation disclosure: continued dissatisfaction**
 - Substantial discontent with pay for performance disclosure remains
 - Adjusted performance measures complicate a meaningful interpretation of pay for performance and may no longer be accepted by investors
- **CSR: expectations and responsibility of the board**
 - Issuers' disclosure of CSR information is considered credible and sufficient
 - Investors are looking for more transparency regarding CSR responsibilities and a more active involvement of the board in this topic
- **Audit: extending reach**
 - The increased transparency in external audit reports through the disclosure of key audit matters is received positively by investors
 - Extending audits on topics such as CSR would generally be welcomed, particularly by international investors



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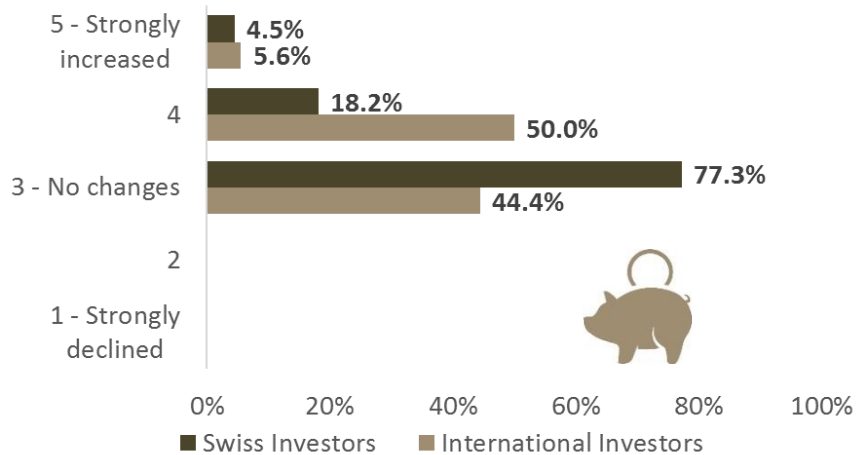
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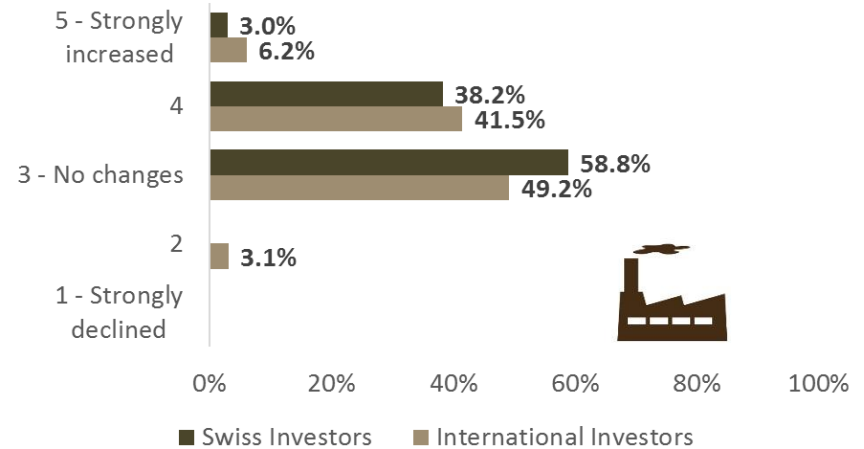
Engagements (I)

Increasing number of meetings

Investors' view on engagement meetings
Sample: investors only



Issuers' view on engagement meetings
Sample: issuers only



- 55.6% of the international investors had more engagements with issuers than last year, this is only the case for 22.7% of the Swiss investors
- Close to half of the investors state that the number of engagements increased
- The increase in engagement meetings is driven largely by international investors

Questions: [issuers] If you engage with investors, how have the engagement meetings with investors, or, respectively, with the organization representing them, developed compared to the previous years? [investors] How have the engagements (direct interaction) with your portfolio companies developed compared to the previous years?

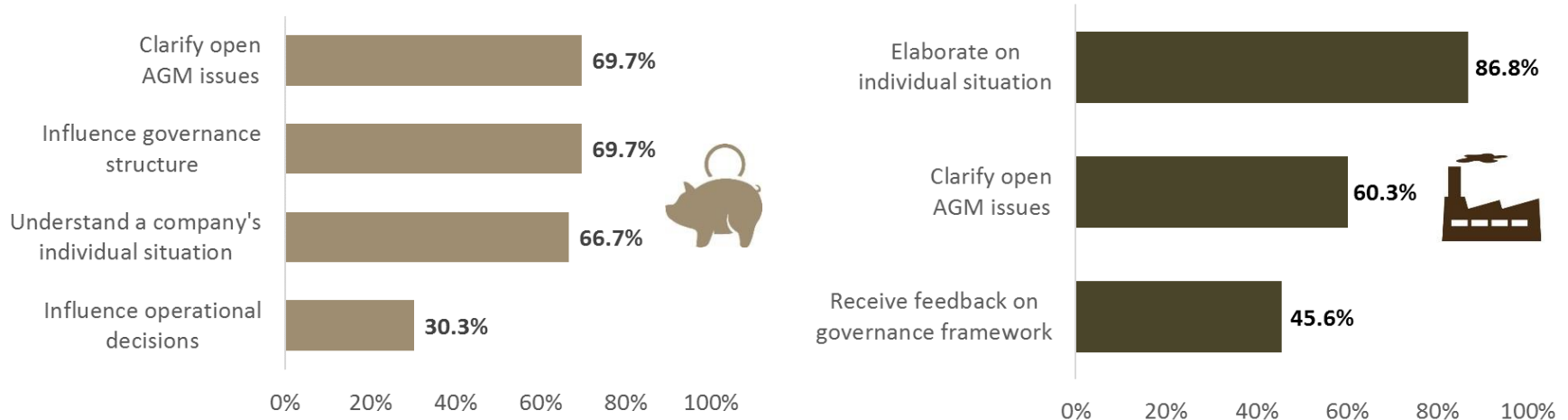


Engagements (II)

How are engagements used?

Content of engagement discussions

(Fraction of investors/issuers agreeing/strongly agreeing with this content)



- Almost 70% of the investors use engagements to actively influence a company's governance structure (governance activism)
- Only a minor fraction of investors use engagements to actively influence a company's operational decisions (traditional shareholder activism)
- A majority of issuers use engagements to elaborate on the individual situation of the company

Questions: [left] If you engage with companies, what role do you see in this direct interaction? [separate question for each category], [right] If you engage with investors, what role do you see in this direct discussion with them? [separate question for each category]



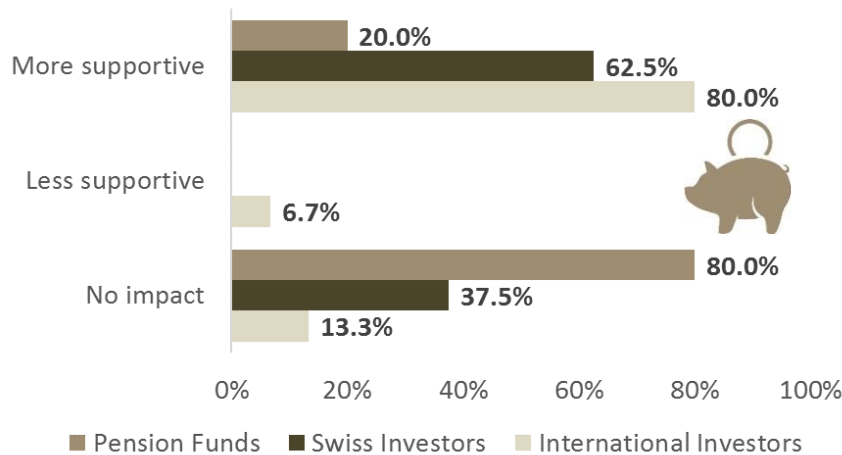
Engagements (III)



Do engagements have an impact?

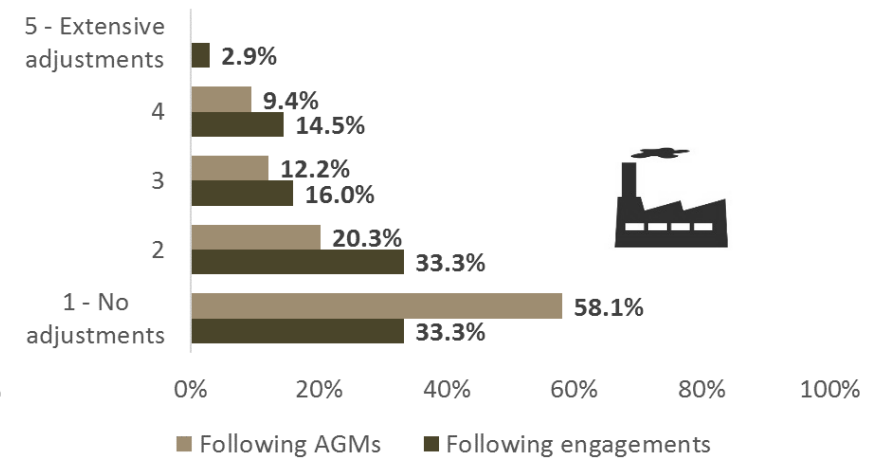
Investors' voting behavior

Sample: investors only



Issuers' adjustments following investor interactions

Sample: issuers only



- Engagements help companies to secure shareholder support at AGMs
- 66.7% of the issuers made adjustments in the company as a result of engagements, while only 41.9% made adjustments as a consequence of AGM outcomes
- The focus of governance discussions shifts from AGMs to engagements

Questions: [left] If you engage with companies, how do these engagements affect your voting behavior? [right, engagements] If you engage with investors, did you make any adjustments in your company due to the engagement discussions of last year? [right, AGM] Did you make any adjustments in your company due to the voting results of last year's annual general meeting?

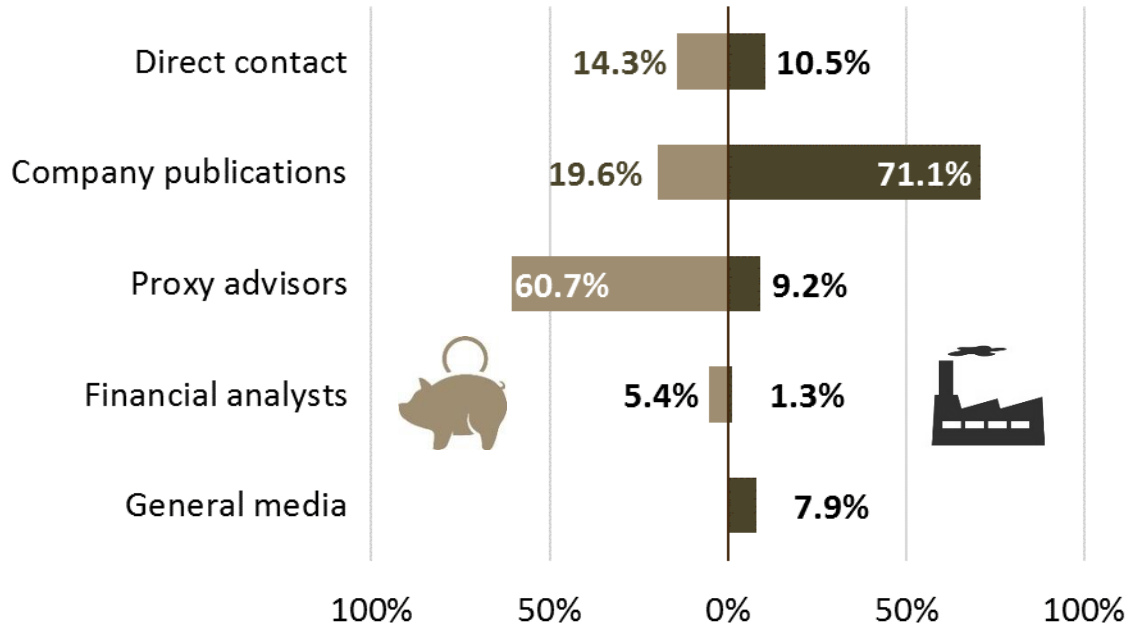


Engagements (IV)



Steering the channel of information

Sources of information



- A majority of investors rely on proxy advisor materials when determining their voting decisions
- Issuers expect investors to rely on information published by the company when taking their voting decisions
- Engagements vs. proxy advisor materials?

	Pension funds	CH asset managers	Int. asset managers
Direct contact	4.4%	-	35.0%
Company publications	21.7%	38.4%	5.0%
Proxy advisors	73.9%	46.2%	55.0%
Financial analysts	-	15.4%	5.0%
General media	-	-	-

Questions: [investors] Please indicate the most relevant source of information for forming an opinion on how to exercise your voting rights.
 [issuers] From your point of view, what is the most important source of information for your shareholders to form an opinion on how to exercise their voting rights at the General Meeting?



Implications: engagements

- Trend of increasing interaction between investors and issuers on corporate governance topics continues and is largely driven by international asset managers
- Engagement meetings are considered more important for a company's governance framework than AGM outcomes
 - Relevant governance discussions (“governance activism”) between investors and issuers take place during the year
 - Positive AGM voting results are often a consequence of previous engagement meetings, leading to a distorted public perception that shareholders may not be critical in their AGM voting
- Issuers risk being assessed according to a standardized “tick the box” framework if no engagement meetings take place
 - «Engage or be managed»



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- Audit topics: extending reach
- Summary and outlook

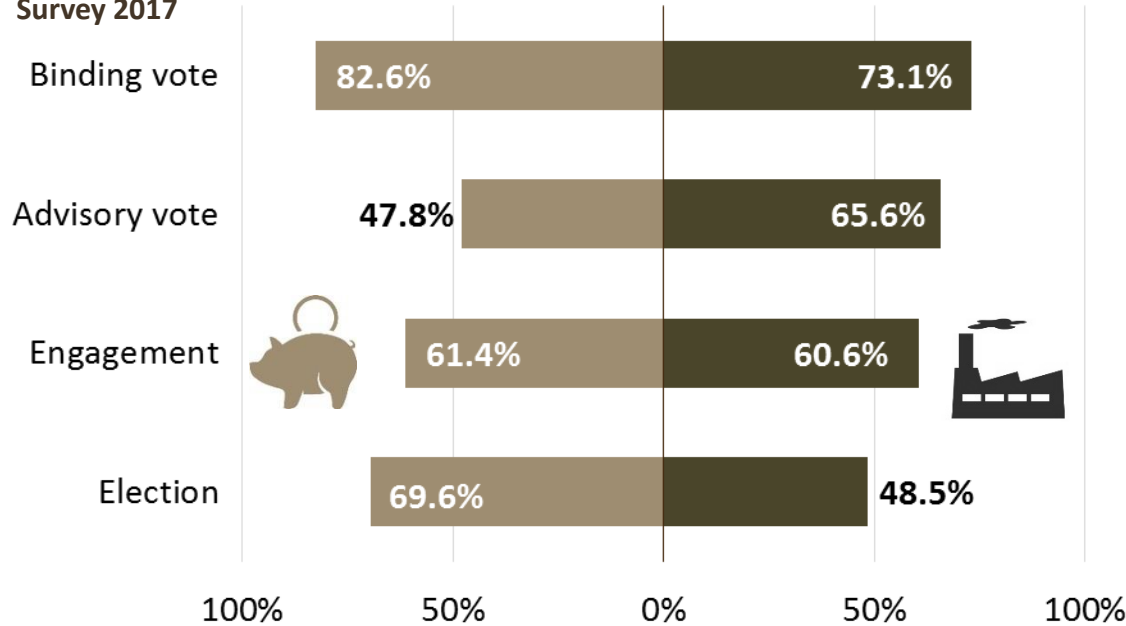


Compensation votes (I)

Shifting views on how to respond



Responding to companies' compensation decisions
 (Fraction of participants considering it an important/very important instrument)
 Survey 2017



- Binding votes on compensation amounts are considered the most important instrument to respond to companies' remuneration decisions
- This contrasts the earlier view of the advisory vote as primary response by investors in case of discontent
- Investors may have reached a better understanding of the binding vote *instrument* and increasingly use it to emphasize their point of view

	Pension funds	CH asset managers	Int. asset managers
Binding vote	72.2%	90.9%	88.2%
Advisory vote	16.7%	45.5%	82.4%
Engagement	43.8%	54.5%	82.4%
Election	55.6%	63.6%	88.2%

Question: How important are the following channels for you as a shareholder to respond to companies' decisions regarding remuneration? [separate question for each category]

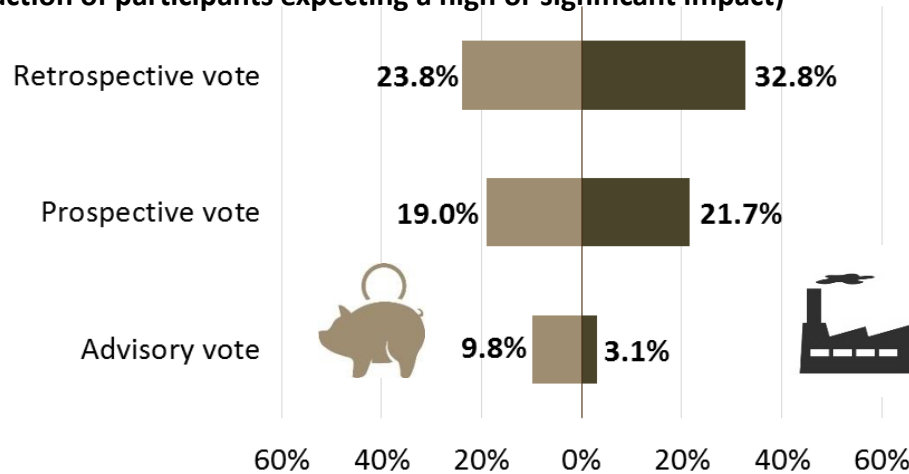


Compensation votes (II)



Limited value impact of rejected binding votes

Impact of rejected compensation votes on company value
(Fraction of participants expecting a high or significant impact)



➤ Despite the binding nature of AGM votes on compensation amounts, only a minority of market participants expects a sizeable impact on the value of a company in case of a rejection

Most critical AGM votes on compensation amounts 2017 (SPI Top 100)

AGAINST Votes	Company	Item (Detail)
64.8%	GAM Holding AG	Variable amount ExCo, current year
38.4%	Credit Suisse Group AG	STI amount ExCo, retrospective
38.0%	Interroll Holding AG	Total amount ExCo, current year
37.7%	ABB Ltd	Total amount ExCo, prospective
28.7%	Valora Holding AG	Total amount ExCo, prospective
65.8%	Sika AG	Total amounts BoD 2015-17, mixed
33.8%	Meyer Burger Technology AG	Total amount BoD, prospective
28.4%	Helvetia Holding AG	Variable amount BoD, retrospective

➤ The rejection of retrospective amounts is clearly seen as more critical

Questions: [binding votes] In your opinion, what are the expected immediate costs of rejected binding AGM votes on compensation amounts? [advisory votes] In your opinion, what are the expected immediate costs of rejected advisory AGM votes on the compensation report?



Plan for this presentation

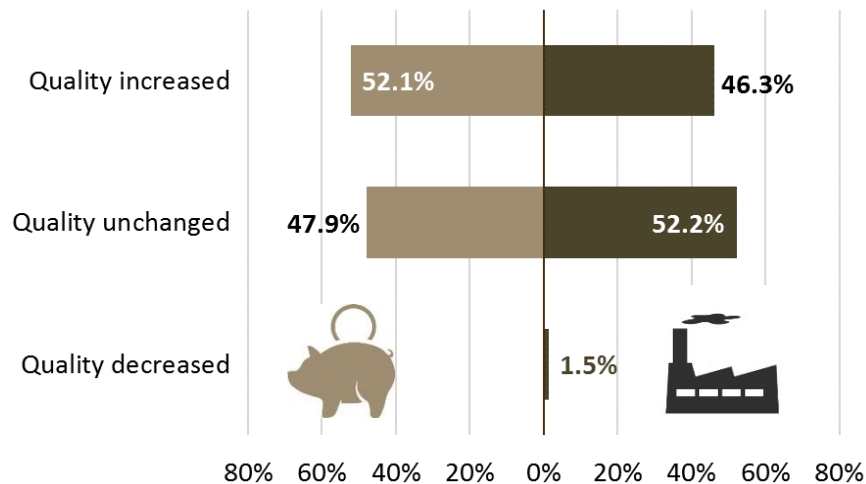
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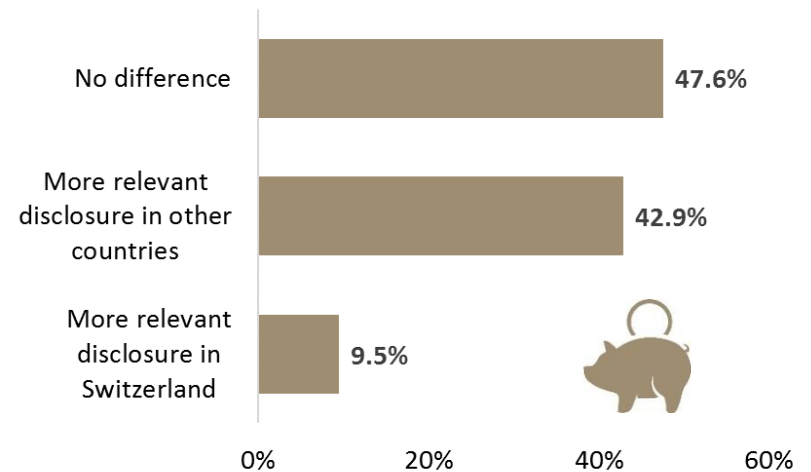
Compensation disclosure (I)

Improving overall disclosure quality

Development of compensation disclosure quality



Comparing compensation disclosure internationally Sample: investors with possibility of international comparison



- Investors and issuers both perceive that compensation-related disclosure has improved or at least remained unchanged compared to 2016
- 42.9% of the investors believe that there is more relevant compensation-related disclosure outside of Switzerland

Questions: [left] How do you assess the quality of the compensation-related disclosure of companies listed in Switzerland during the AGM season 2017 compared to the AGM season 2016? [right] How do you assess the general disclosure quality of compensation-related information during the AGM season 2017 compared to the disclosure in other countries (e.g. Anglo-Saxon countries)?

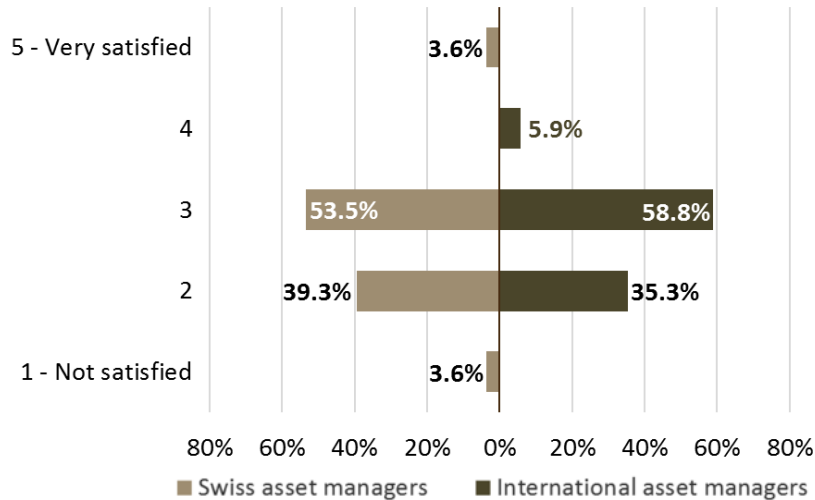


Compensation disclosure (II)

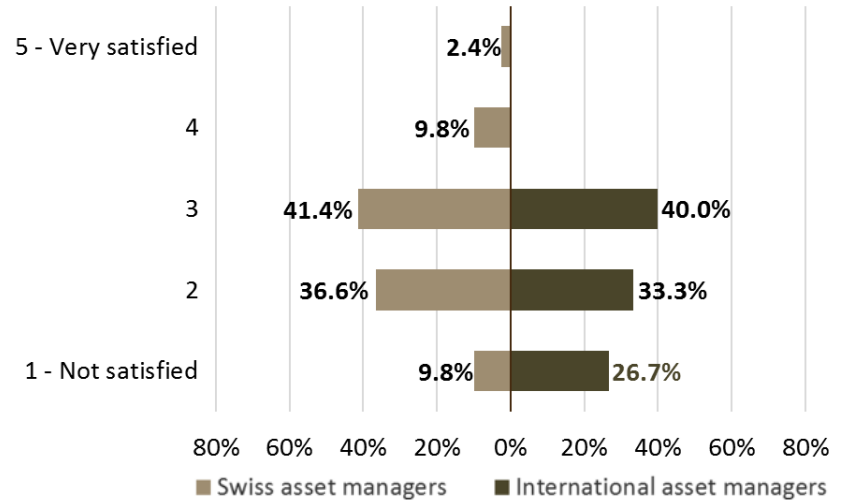
“Pay for performance” disclosure quality issues



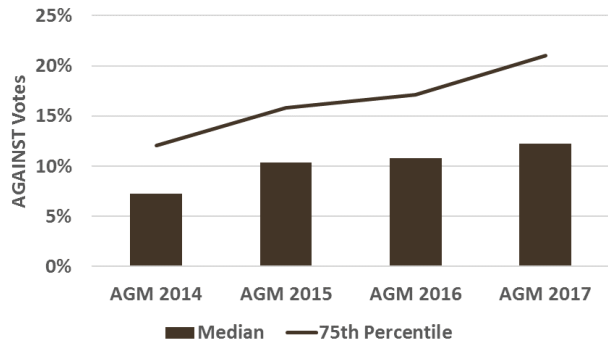
Satisfaction with pay for performance disclosure
Sample: investors only, 2017



Satisfaction with pay for performance disclosure
Sample: investors only, 2016



Fraction of AGAINST votes at AGMs 2017
(advisory votes on remuneration report, Top100 SPI issuers)



- Pay for performance disclosure remains an unresolved issue for investors
- The continued dissatisfaction with this disclosure is reflected in the growing fraction of AGAINST votes at AGMs and the generally higher levels of AGAINST votes compared to abroad (e.g., UK or US)

Question: How do you assess the information with regard to the comparison of achieved performance targets and the payout of variable compensation elements (pay for performance) during the AGM season 2017 [2016]?

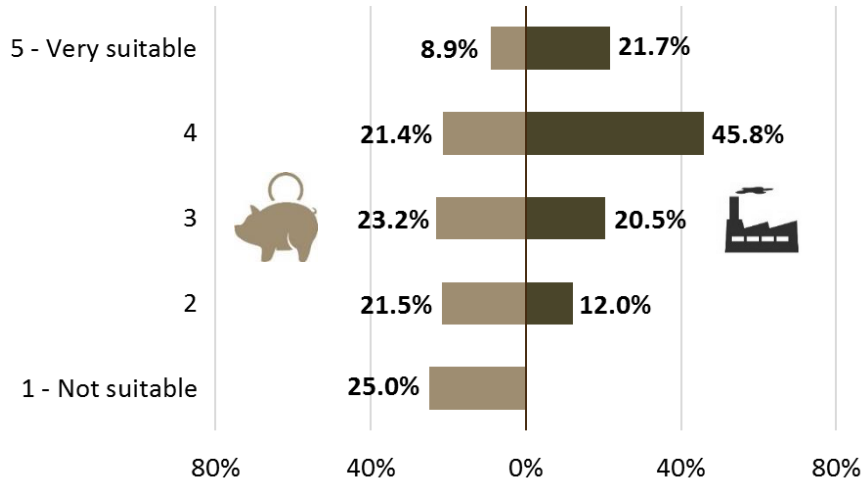


Compensation disclosure (III)

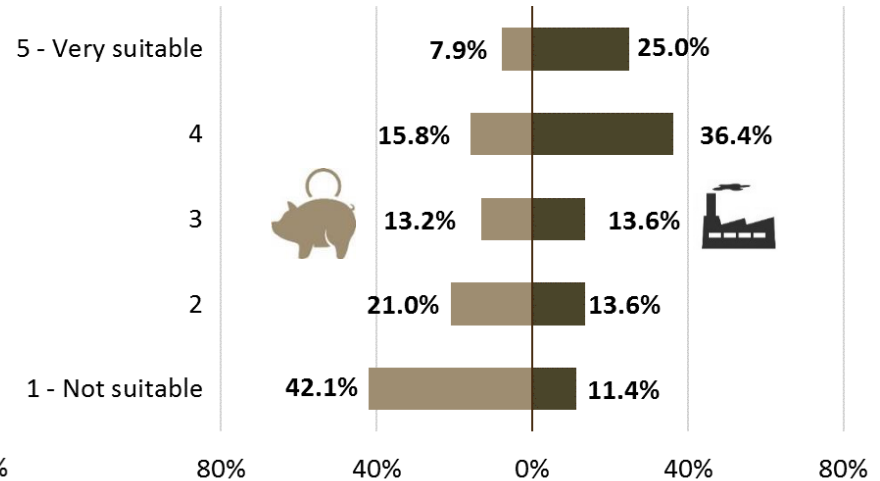
Dissent regarding adjusted performance measures



**Suitability of adjusted performance measures
Survey 2016**



**Suitability of adjusted performance measures
Survey 2014**



- Past surveys indicated that investors and issuers have a split opinion with respect to the suitability of adjusted, non-audited performance measures though this divergence has somewhat decreased
- A large fraction of investors believe that adjusted performance measures are not a suitable basis for performance-based compensation, while more than half of the issuers consider these measures suitable

Question: Please indicate how suitable the following performance measures are, in general, to determine the size of the variable compensation component: - Adjusted profit, i.e. profit that does not reflect extraordinary items such as fines, mergers, etc.



Implications: compensation

- Investors will increasingly use their binding vote on compensation amounts to shape compensation systems
- Performance-based compensation depending on adjusted, non-audited numbers is generally more difficult to understand for investors
 - Discretion in the definition of adjustments
 - Difficulty to compare over time
 - Consistency of adjustments over cycles
- This may be a cause of investors' continued discontent with the pay for performance disclosure that has arguably led to higher opposition in compensation-related AGM votes in Switzerland



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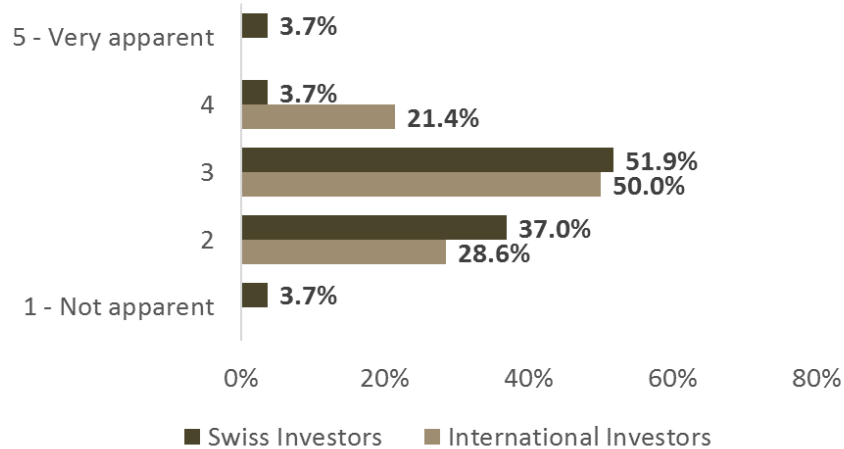
Corporate Social Responsibility (I)

Responsibility not apparent

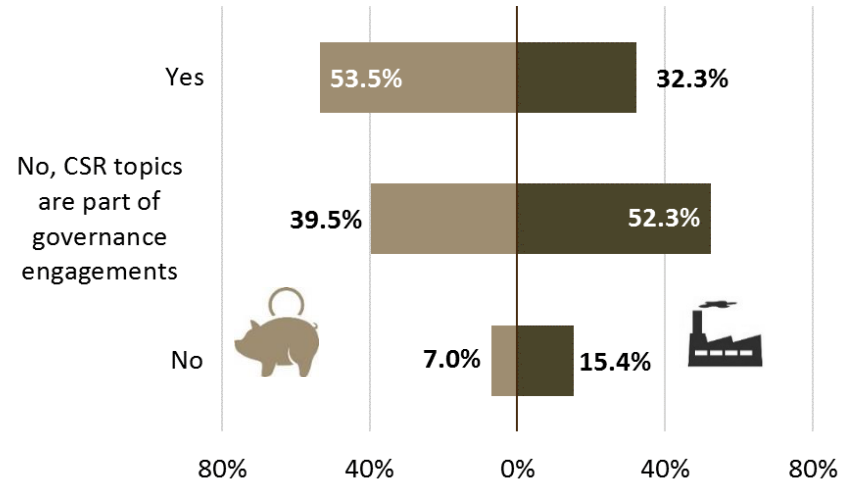


Disclosure of CSR-related responsibility

Sample: investors only



Necessity of specific CSR engagements of the board



- 40.7% of Swiss and 28.6% of international investors are looking for a more transparent disclosure of the CSR-related accountability within the company
- According to the survey 2016, investors clearly expect that the board is taking responsibility for CSR topics
- Investors are looking for additional efforts by boards to engage specifically on CSR topics

Questions: [left] Is it generally clear in the publicly available company information who is responsible for Corporate Social Responsibility and Sustainability in the company, and what processes are implemented respectively? [right] Should the Board of Directors or individual members of the Board increasingly engage in corporate social responsibility (CSR) issues with the most important organizations in this field?

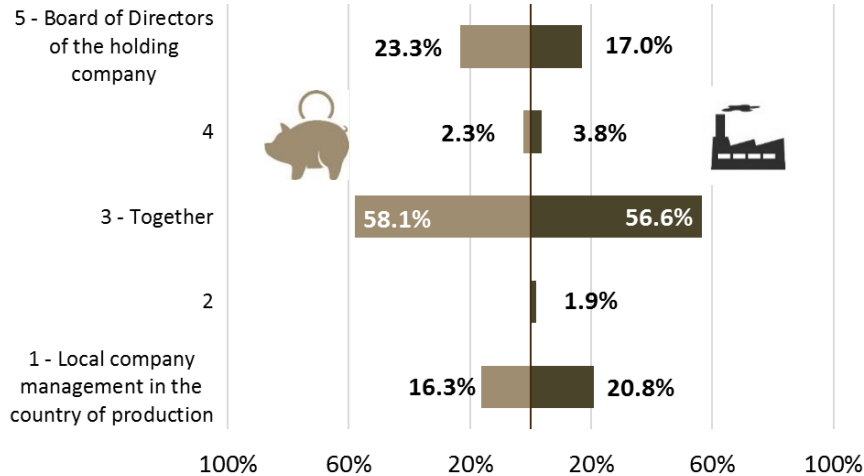


Corporate Social Responsibility (II)

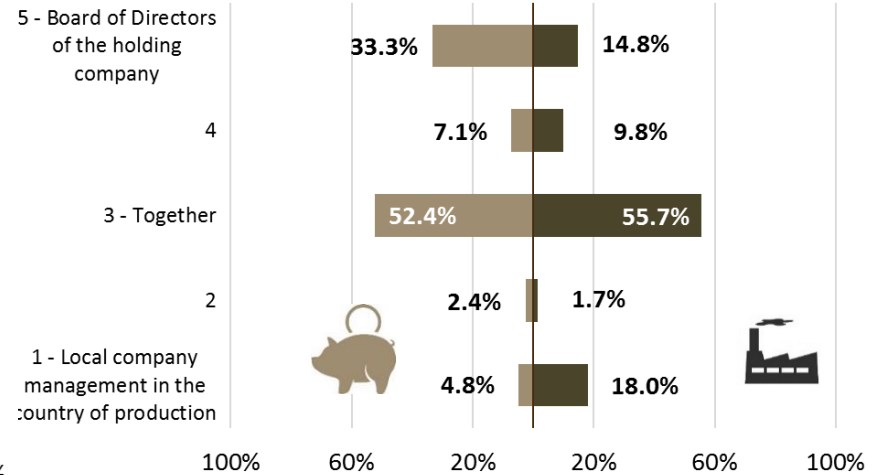
More board responsibility



Responsibility for CSR compliance In industrialized countries



Responsibility for CSR compliance In developing countries



- In general, investors and issuers perceive both the board of directors as well as the management in the country of production as being responsible for ensuring compliance with minimum CSR standards
- For developing countries, more than 40% of the investors expect the board of directors to assume more responsibility

Question: Who should take responsibility for compliance with ecological and social minimum standards?



Implications: corporate social responsibility

- Investors are clearly assigning the responsibility for CSR topics to the board of directors
- In light of the «responsible business initiative», investors' opinions on CSR-related topics should be taken particularly seriously and communication around CSR and related processes in companies is rapidly gaining more importance
- An objective outside opinion (e.g., an external audit) on an issuer's efforts to comply with CSR standards may increase the confidence of investors and the public



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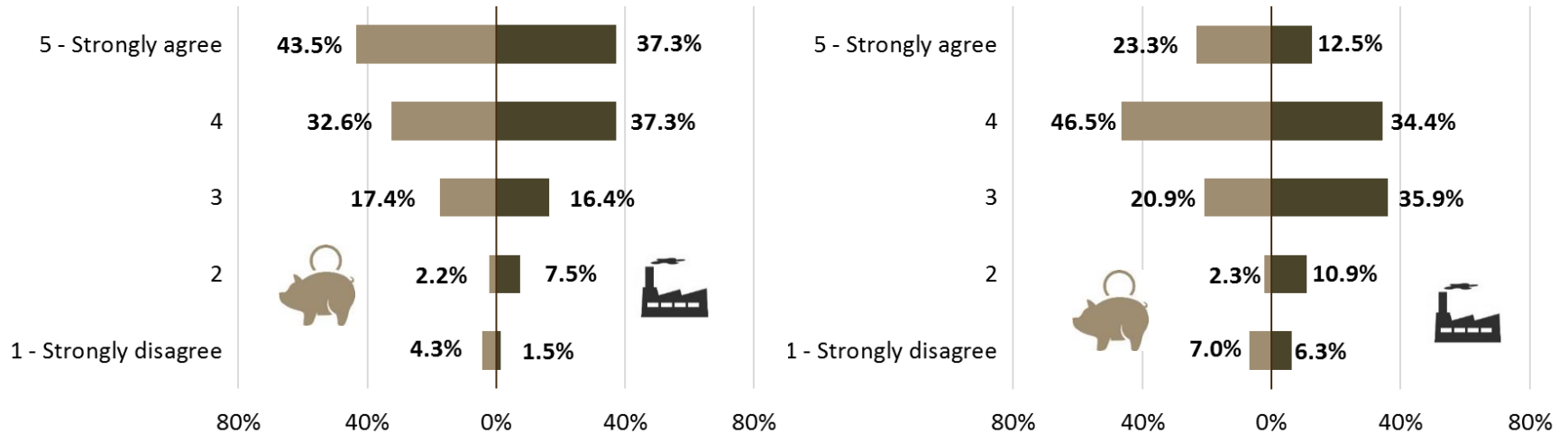
Audit topics (I)

Reducing the information gap



External audit increases confidence

Value of disclosure of key audit matters



- Investors and issuers agree that an external audit increases confidence in the financial reporting
- The additional disclosure on “key audit matters” is received well by a large fraction of investors and almost half of the issuers

Questions: [left] How do you assess the following statement: "The availability of an external audit report increases the confidence in a company's published financial reporting"? [right] How do you assess the following statement: "The newly introduced reporting of key audit matters for public companies in Switzerland allows a better insight into the conducted external audit"?



Implications: independent audit

- Empirical work suggests that independent audits on financial reporting help to reduce the information gap between shareholders and companies
- Issuers frequently use adjusted, non-GAAP measures in their communication with investors and generally base their performance-linked compensation plans on these measures
- These adjustments are often difficult to reconcile for shareholders, particularly over time and thus increase the information gap again
- Investors' positive reaction to the disclosure of "key audit matters" suggests that additional audits of adjusted, non-GAAP measures by an independent auditor is of value for investors

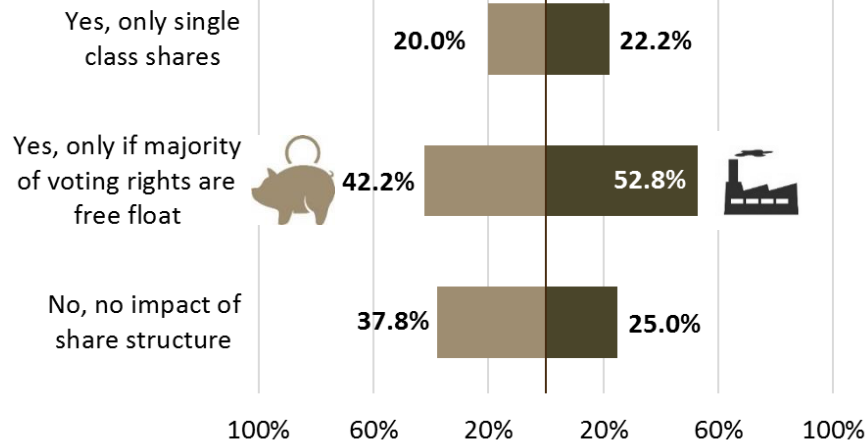


Shareholder rights: Lead-index inclusion of dual-class shares



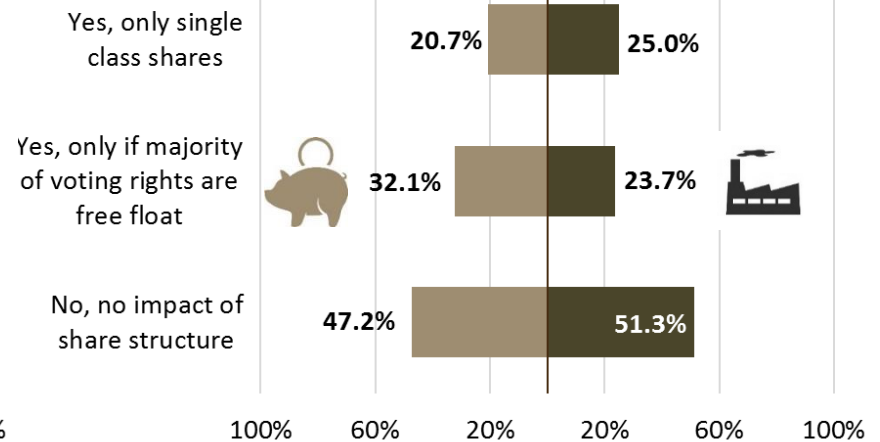
Selection of lead-index constituents

Survey 2017



Selection of lead-index constituents

Survey 2016



- Investors and issuers alike seem to change their view on whether dual-class shares should be included in lead-indices
- While in 2016 almost half of the investors and issuers stated that share structure should have no impact on index securities selection, this year only 37.8% of the investors and only 25.0% of the issuers continued to share this opinion

Questions: 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?



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Summary and outlook

- Investors increasingly use engagements to influence the corporate governance framework of issuers
- Corporate governance engagements with investors are important if companies expect to be judged according to their individual situation instead of a standardized requirement catalogue
- Investors are increasingly willing to use binding votes to emphasize their viewpoints regarding compensation-related issues
- The use of adjusted (non-GAAP) performance metrics may increasingly lead to conflicts between issuers and investors
- Investors look for a more transparent and active assumption of responsibility for CSR-related issues by the board, an important indicator also in light of the «Responsible Business Initiative» (Konzernverantwortungsinitiative)



Further scope of the survey

Some additional questions covered by the survey:

- Board of directors: relevance of board elections, composition of the board and related disclosure
 - Determinants of the composition of the board
 - Relevant assessment criteria
 - Board performance evaluation criteria
 - Board rotation processes
 - Regulation regarding board composition
- Compensation-related issues
 - Compensation benchmarking
 - Replacement awards