

Update on the latest Swiss governance developments: Action needed

Recently, important political decisions were taken regarding the future frameworks of Swiss companies and their shareholders:

1. **After more than a decade of deliberations, the Swiss parliament adopted a broad revision of the Swiss stock corporation law. Among others, the revision significantly strengthens shareholders' rights. Companies should make use of the transition time of two years until the revision becomes effective to strengthen their corporate governance and corporate social responsibility frameworks, improve disclosure quality, and intensify stakeholder engagements.**
2. **The Swiss parliament adopted an indirect counter-proposal against the stringent "responsible business initiative" (RBI). A national referendum will be held later in 2020 on the two proposals. The RBI would hold Swiss companies liable internationally for insufficient diligence in environmental and social matters not only within their own organization but importantly also for the actions of their suppliers. Moreover, the burden of proof would be reversed and rest with the companies. Going into this referendum, it will be crucial that the public understands the effort Swiss companies are undertaking, the benefits of the disclosure-based counter-proposal, and the drawbacks of the far-reaching RBI for Switzerland as a business location.**
3. **The federal council recently adopted a report and guidelines regarding "Sustainable Finance". The government intends to provide a supportive environment in Switzerland to develop a "leading sustainable financial center". It is now the industry's responsibility to build on this framework and develop the tools needed to effectively contribute to sustainability. This should include strategies for active ownership and socially responsible investment processes, including stewardship, instead of the still widely-spread ESG labeling and exclusion approaches.**

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Revised stock corporation law

The revision clarifies certain market practices, provides more flexibility for Swiss companies, and formally transfers the provisions of the Ordinance against Excessive Compensation (OaEC) with three add-ons (the gender quota, the information-sharing restrictions for the independent proxy, and the mandatory advisory vote on the compensation report in specific settings) into law.

A boost to shareholder rights

The revision significantly lowers certain hurdles for shareholders rights:

- **Placing an item on the official AGM agenda:** Shareholders representing 0.5% of the capital/voting rights in a listed company, substantially reduced from formerly 10% or shares with a nominal value of at least CHF 1mio.
- **Calling shareholder meetings:** Shareholders representing 5% of the capital/ voting rights (formerly 10%) can call for a shareholder meeting.
- **Legal actions:** The revision facilitates shareholders to take legal action at the expense of the company or to call a special investigation against the company.

Notably, the provision for shareholder-sponsored agenda items reduces the threshold to one of the lowest levels amongst comparable capital markets. There are currently more than 100 institutional shareholders whose total shareholdings amount to more than 0.5% of the SMI® companies' average market capitalization and the largest 15 institutional



investors together control on average 50% of the SMI® companies. This low threshold combined with the new limitations on the information flow from the independent proxy to the company (see below) will likely render AGMs less predictable, making a comprehensive disclosure and intensified shareholder engagement imperative for boards of directors. To preempt shareholder activism and avoid unexpected AGM outcomes, companies should make use of the transition time of two years until the revision becomes effective to further build trust in their governance and CSR frameworks. This entails reviewing current structures, including the board's composition, updating processes where necessary and continue integrating strategy, incentives, capital structure and allocation with governance and corporate social responsibility and further work on the related disclosure.

Clarified compensation rules/incorporation of the provisions of the OaEC into stock corporation law

- **Approval of compensation amounts:** Companies remain free in their choice of the compensation voting scheme, i.e. they can vote retrospectively or prospectively on compensation amounts and elements.
- **Replacement-awards** for foregone benefits at the former employer are formally permitted.
- **Advisory vote on compensation report** becomes mandatory only in cases where variable compensation amounts are subject to prospective voting schemes.
- **Post-employment payments** for a non-compete provision are capped at the executive's average total compensation over the past three years.

A more flexible capital structure

- **Introduction of a capital band** through inclusion in the Articles, providing the board the right to increase/decrease the registered share capital by up to 50% over a 5-year period, subject to certain limitations such as anti-dilution provisions (until now, authorized capital could be approved for a 2-year period only).
- **Possibility of interim-dividends during the year**, subject to shareholder approval.

More gender diversity

- **Target gender quota of 20% for executive committees and 30% for boards of directors** of publicly listed companies. These targets are subject to a comply-or-explain rule, whereas the reasons for not reaching the quota and measures taken will have to be provided in the compensation report. Explanations become mandatory after a 5-year (for boards) and 10-year (for executives) transition period.

New ways to organize the AGM

- **Virtual AGMs without shareholder presence** are permissible as long as virtual participants are properly identified and can directly participate in the AGM votes as well as in the AGM discussion.
- **Information of the independent proxy to the board about voting behavior of shareholders becomes restricted** to general trends and can be provided no earlier than three days ahead of the AGM. The independent proxy needs to report to the AGM on information shared with the board.

With this limitation on information flow and the short notice period, shareholder meetings will become less predictable and time for action ahead of an AGM is quite short. Together with lower hurdles for shareholders, it becomes vital for boards to have sound corporate governance structures and regular shareholder engagements in place.

Up next: Responsible Business Initiative (RBI)

The RBI would provide persons affected by ecological and social misconduct with significant rights to hold Swiss companies and their boards accountable for their actions, not only within their own organization but also for the actions of their suppliers and business partners. Further, the burden of proof would lie with the board instead of the plaintiff. This makes the RBI a much stronger intervention into entrepreneurial activity than comparable regulation proposals in other countries and will throw the gates wide open for commercially motivated claims against Swiss companies. Parliament finally approved an indirect counterproposal addressing the RBIs potentially harmful shortcomings with requirements for a more comprehensive disclosure on social and environmental matters. Such regulation would be similar to those of other countries, for example, the "human rights due diligence"-initiative in the EU. A



meaningful disclosure coupled with strong shareholder rights arguably allows a much more nuanced and effective way to hold companies responsible in cases of ecological and social misconduct. The benefits of the counterproposal need to be made clear to stakeholders, particularly the Swiss voters, who will ultimately decide between the RBI and the counterproposal later this year.

Sustainable Finance: The Swiss strategy

In June, the Swiss federal council released a report and guidelines on sustainability in Switzerland's financial sector. The goal of this strategy is to improve (i) legal certainty with respect to fiduciary duties related to environmental risks and impacts, (ii) to increase the transparency of the financial sector in this regard, (iii) to provide guidance on identifying and reflecting environmental and social risks in current pricing, and (iv) to monitor international developments, in particular in the EU, in this field. The government clarified that it will assume a subsidiary role and support the financial market in achieving these goals through education and research initiatives, the development of sustainability and environmental labels, and by supporting innovation in the green fintech sector.

The government's initiative to facilitate the development of a more long-term oriented financial sector through self-regulation should be viewed positively. It is now up to the financial industry to respond to the government's trust with credible action and recognition that considerable efforts are still needed to become a leading global hub for sustainable financial services. A promising starting point in this regard would be an investor-sponsored stewardship code for Switzerland, defining a common framework for active and responsible ownership including engagements with companies.

The currently predominantly practiced labeling of financial products is related to investment strategies based on hard exclusion criteria, largely ignoring the urgently needed stakeholder dialog. Exclusion approaches will generally not make environmentally or socially critical companies better citizens, but only change their shareholders from more to less caring ones. Experiences from markets further advanced in these matters have been showing that this can be a fertile ground for non-effective "greenwashing".

Years ago, it was shown by research and is meanwhile acknowledged by practice that a company's corporate governance cannot be summarized in a single score or otherwise be standardized. It is not clear why this should work for the many more dimensions of environmental and social metrics. Hence, instead of labeling, the industry should put its efforts into transferring its currently still highly exclusion-based investment approaches to engagement-based and more pragmatic strategies, in which investors use their voice and shareholder power to improve the long-term sustainable performance together with their investee companies.

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