

## Corporate Governance in light of Covid-19: A review of the situation

Zurich, April 14, 2020 – Due to an Ordinance issued by the Swiss Federal Council, the majority of annual general meetings (AGM) in Switzerland can take place as planned, albeit without shareholder attendance. The latter, however, does not seem to have a major impact, as the AGMs held so far show an almost unchanged level of participation. Due to the current situation, international proxy advisors are making increasing use of case-by-case guidelines, which among other things leads to a later than usual publication of their recommendations. A higher level of scrutiny in the assessment of remuneration can be observed, especially for companies that are particularly affected by the coronavirus crisis. However, the actual governance challenges of the current crisis are only just beginning to emerge. They relate, in particular, to a more transparent payout policy, the performance-related remuneration, possibly necessary financing requirements, and changed strategic challenges in the value chain, which ultimately has an impact on the overall governance and, therefore, the board of directors. Consequently, an active leadership role of the board of directors and an intensive dialogue with the most important stakeholder groups are more important than ever.

### Covid-19: AGM season 2020 in Switzerland

The impact of the Covid-19 virus on the AGM season in Switzerland would have been extensive if the Federal Council had not acted quickly and issued the "Ordinance 2 on Measures to Combat Coronavirus" on 13 March 2020. Subsequently, Switzerland was the first country in the world to allow companies to conduct their AGMs without physical presence of shareholders due to Covid-19. Although this will eventually become possible as part of the revision of the Swiss company

### Upcoming Events

#### SWIPRA Analysis AGM Season 2020

Publication  
June 2020

#### SWIPRA Corporate Governance Survey

Presentation key findings  
3 November 2020

#### Swiss Corporate Governance Dialog

Event for issuers/investors  
2 December 2020

law, it is not provided for under the current system. As a result of the Ordinance, the AGM season in Switzerland can now take place as planned for most part. Shareholders' votes are consequently represented exclusively by the independent proxy.

Our first analysis of the general meetings of the largest 100 companies listed in Switzerland to date shows no significant influence on the general meetings so far. In particular for the medium and smaller sized companies, the proportion of shareholders' votes cast has even risen slightly. Moreover, despite the crisis, the majority of shareholders are sticking to their expectations towards the companies and are also not shy of voting critically, in particular on remuneration reports, where the proportion of against votes has generally increased.

### Covid-19: General meetings worldwide

A recent analysis published by the proxy advisor Institutional Shareholder Services (ISS) suggests that around half of the world's AGMs have been postponed, while the other half are now held virtually. New regulatory guidelines regarding the format or postponement possibilities of AGMs are published almost daily. Companies in Europe and the US now have the option of holding meetings virtually or online, or postponing the AGM until the end of June, or in

Germany even until the end of the calendar year. In contrast, listed companies in Japan or Hong Kong are still required to hold physical meetings, but have the option of postponing them to a later date.

### **Covid-19: General influence on corporate governance and expectations of regulators, investors and proxy advisors**

How this global crisis will ultimately impact corporate governance frameworks in the medium term remains to be seen. However, it has become clear how important a functioning corporate governance framework is to ensure effective crisis management. This extraordinary situation will increase the focus on the work of the board of directors (BoD) even more.

#### **Expectations Regulators**

[Swiss Financial Market Supervisory Authority](#)

[European Central Bank](#)

[Prudential Regulation Authority \(UK\)](#)

Recommendations on payout policy issued by the Swiss Financial Market Supervisory Authority (FINMA) as well as the Prudential Regulation Authority (PRA) and the European Central Bank show that companies in Switzerland must keep a close eye on possible spill-over effects caused by requirements and expectations from the EU or the UK. In particular, boards of directors have a duty to position "their" company even more explicitly and communicate actively with respect to the following key issues:

#### **Corporate Social Responsibility**

This crisis is a test for the corporate social responsibility agendas of many investors and respective frameworks propagated by companies, especially with regard to employees and within the value chain, i.e. for customers and suppliers. The current situation will show the extent to which this issue is truly anchored in the board of directors and the extent to which the board has taken leadership in this respect. Although the board is not responsible for the operational management in dealing with the crisis, it is expected to

#### **Expectations Proxy Advisors**

[ISS](#)

[Glass Lewis](#)

provide management with a framework that offers guidance in dealing with the crisis. In particular, when deciding on actions, the board should determine the prioritization and balance of the burden between the various stakeholders.

In recent years, investors have increasingly focused on the processes and organization of the board. In this time of crisis, many institutional investors are demanding that their focus should now clearly be on the social component, i.e. human capital management. Accordingly, this year the priorities in the dialogue between investors and companies, the engagements, are likely to shift to some extent from climate-related to socially relevant issues.

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"The coronavirus crisis is a systemic risk that continues to spread in unpredictable ways, and we must first respect and prioritise the health of individuals and risks to public health systems. But the significant economic impact is adversely affecting companies and markets, and it is important for the investor community to remain calm and maintain a long-term perspective that will be supportive of companies navigating this challenging environment. Investors will also look to boards to provide leadership in crisis management to survive near-term pressures and to act strategically to maintain the ability sustainable value over time."

*George Dallas,  
Policy Director,*

*International Corporate Governance Network, 12 March 2020*

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#### **Liquidity management and payout policy**

In the pursuit of higher dividend yields, steadily rising dividend amounts and more share buybacks financed through the capital market or loans have been observed in recent years. Consequently, the liquidity reserves in certain sectors and companies are currently

rather scarce and must be supported by operational measures, rigorous liquidity management, and possibly later by additional financing measures. There is a risk of higher balance sheet leverage and the associated negative impact on credit ratings.

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"Where companies seek additional capital we would expect their board to suspend dividends and reconsider management's remuneration. We would expect management to share in some of the pain. If the companies need capital, they should have an expectation that their compensation should also bear some cuts."

*Jessica Ground,  
Global Head of Stewardship, Schroders, 2 April 2020*

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Against this background, it is clear that the often-rigid distribution policies, which are based solely on the absolute dividend level of the previous year, prove to be useless in times of crisis. As SWIPRA has previously pointed out, a transparent and clearly formulated payout policy will become much more important in companies' governance frameworks. Accordingly, it is essential for boards to anchor the payout policy even more clearly in the financing strategy, the liquidity management and the remuneration policy, and to communicate it actively. It is not uncommon for companies to have credit rating targets that currently may be affected. Accordingly, the leadership of the board of directors is called upon to define a shared value policy that defines a framework for how the company's key stakeholders should participate equally. Supervisory authorities in Europe, including FINMA, recommended that companies, especially banks and insurance companies, reconsider or postpone their dividend proposals for the financial year 2019 until the systemic effects of the crisis have become more transparent. In addition, several major international institutional investors are calling on companies across sectors to prioritize employment and supply chain security over shareholder returns in the short term. While the proxy advisor ISS has not yet requested an explanation from companies on how the liquidity

created by dividend cuts is being allocated within the company, some institutional investors are considering voting against all dividend proposals in specific sectors. Some long-term investors have also announced that their support for capital measures, such as dilutive capital increases, will depend on the current willingness of the board to carefully consider the future distribution of earnings, i.e. the payout policy.

### **Compensation**

A crisis should also be considered an indicator for the quality and robustness of existing compensation systems. If a compensation committee has done its job well in the past, i.e. if it has calibrated the incentives appropriately and clearly communicated the compensation policy to management, then there is hardly any need to make adjustments to the structures, even in view of the current situation. Given the current circumstances, the short-term bonus for the year 2020 may be smaller or even fully void as the corresponding targets can hardly be achieved in the current situation. Successful crisis management must be reflected in the increase in value of the long-term remuneration, typically in the form of share awards. The potential for an attractive increase in value from the newly allocated long-term remuneration elements is intact, as they are based on a currently rather lower valuation level.

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"Trying to make executives whole at even further expense to shareholders and other employees is a certainty for proposals to be rejected and boards to get thrown out—and an open invitation for activists and lawsuits onto a company's back for years to come. Even those companies who project a "business as usual" approach to executive pay will face opposition if employees and shareholders see their own "paychecks" cut. Companies would be wise to avoid this."

*Glass Lewis  
"This is the Glass Lewis' Approach", 26 March 2020*

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This is particularly important if the company asks shareholders and employees to make short-term sacrifices, primarily due to liquidity bottlenecks and insufficient profitability. In the spirit of "shared pain", investors will carefully review decisions on management compensation for the past and current financial year and expect discretionary downward adjustments or the avoidance of excluding extraordinary items from the performance assessment respectively, if the poor results for shareholders are not adequately reflected in the compensation system. Proxy advisor Glass Lewis has communicated that companies should avoid compensation that is not in line with shareholder returns. Spill-overs from compensation decisions are then expected. ISS has already declared before the 2020 AGM season that it will increasingly hold the board and, in particular, the compensation committee accountable. Negative recommendations in the elections are correspondingly more likely in the event of remuneration-related concerns.

### **Covid-19: Key Take-aways**

A crisis like Covid-19 puts a stronger focus on a functioning corporate governance and thus on the

board of directors. Unexpected circumstances sometimes call for unconventional and individually tailored measures; there is no such thing as "best practice." In these times, it is therefore essential that the board of directors not only decides on what it considers to be the best measures for the company, but also actively communicates them for the future, both internally and externally. Engagements with key shareholders and stakeholder groups in the "post-Corona period" are essential to secure approval for the necessary measures. This will build important trust and helps the board of directors to proactively opine on the further increase in shareholder activism.

#### **About SWIPRA Services**

SWIPRA Services provides corporate governance services for companies and their boards of directors as well as for institutional investors. We work with our clients with the aim of increasing the value of the company in the long term, based on principles of value-based management and empirically relevant criteria. [www.swipra.ch](http://www.swipra.ch)

#### **About Morrow Sodali**

Morrow Sodali is a leading provider of strategic advice and shareholder services to corporate clients around the world. The firm provides corporate boards and executives with strategic advice and services relating to corporate governance, shareholder and bondholder communication and engagement, capital markets intelligence, proxy solicitation, shareholder activism and mergers and acquisitions. [www.morrowsodali.com](http://www.morrowsodali.com)

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