



SWISS PROXY ADVISOR
FOUNDATION FOR VALUE
BASED INVESTMENTS

Year one after the Ordinance against Excessive Compensation

– Insights and Challenges –

A Survey by SWIPRA

Zurich, November 18, 2014

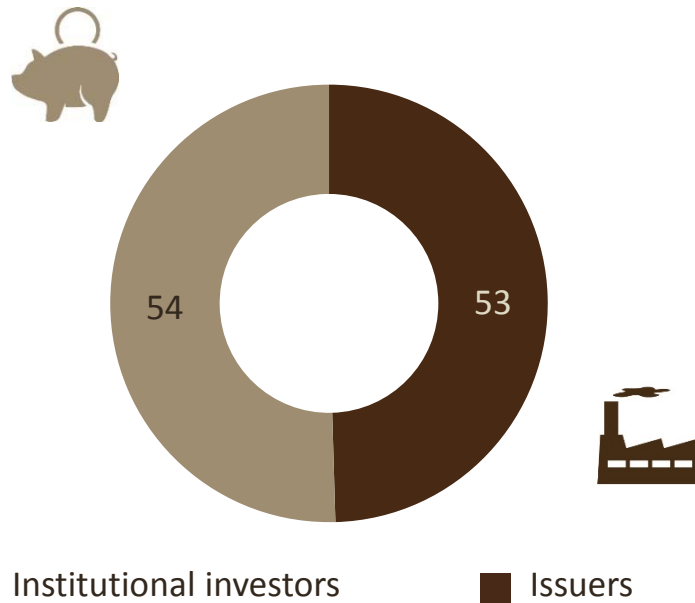


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Participants



A total of 107 participants filled out the survey

Issuers: 53

Pension funds: 36

Asset managers: 18



Participating industries

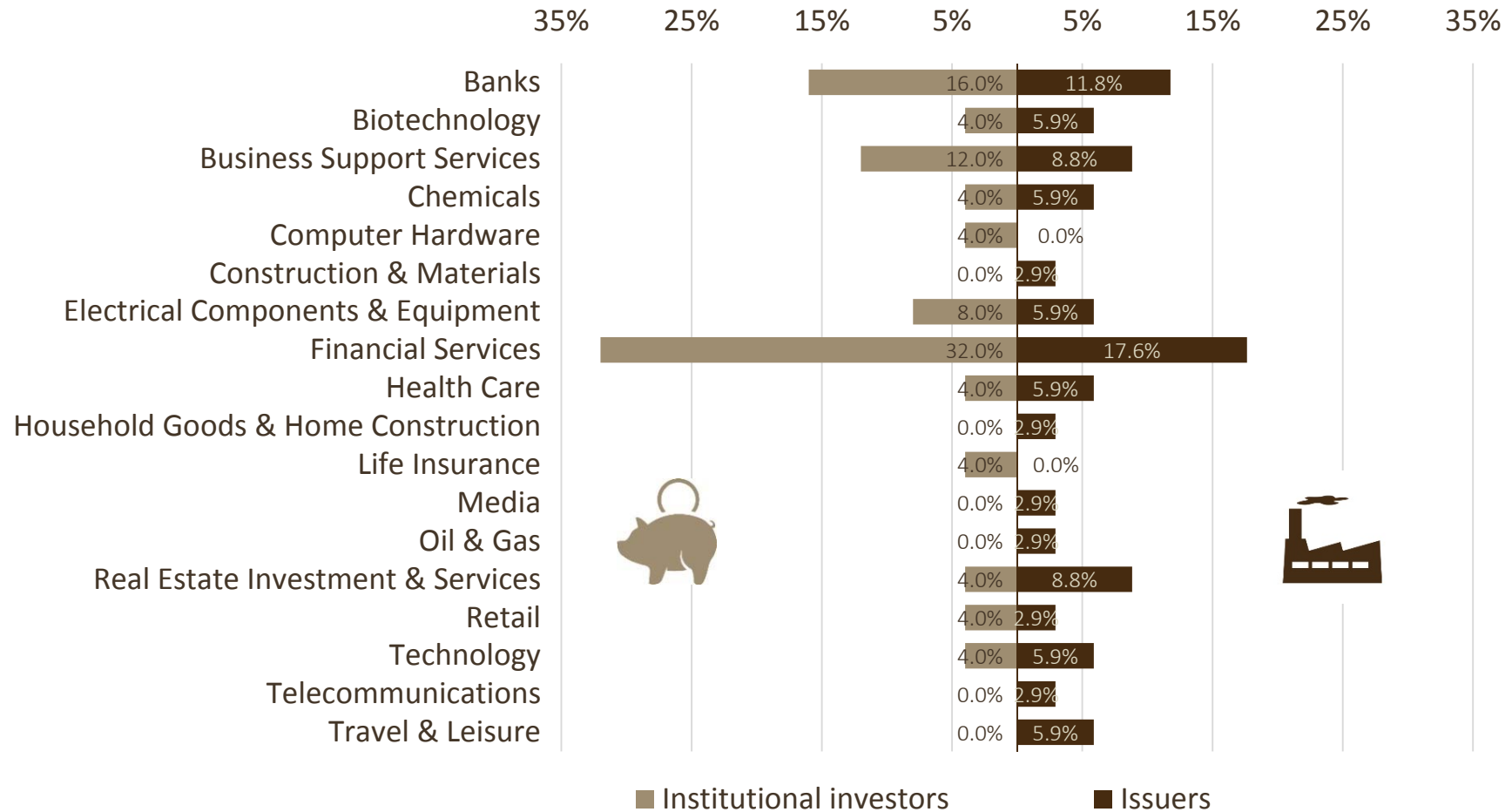




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Key results (I/II)



➤ **Disclosure of pay-for-performance:**

Institutional investors perceive a transparent disclosure of the relation between the achievement of performance goals and the associated variable compensation payout as considerably more important than issuers

➤ **Key performance indicators for bonuses:**

Issuers – but not institutional investors – consider profit figures *adjusted* for special items an adequate basis for the assessment of bonus payments



Key results (II/II)



- **Compensation structure:**
 - Issuers put a greater weight on the share of *short-term* performance related compensation in the total pay mix than institutional investors
 - The share of forward-looking *long-term* compensation in the total pay mix is considered as substantially less important by issuers and pension funds than by asset managers
- **Challenges for the compensation voting schemes:**

Survey participants agree that prospective votes on compensation amounts require a higher level of disclosure of the compensation system than retrospective votes.



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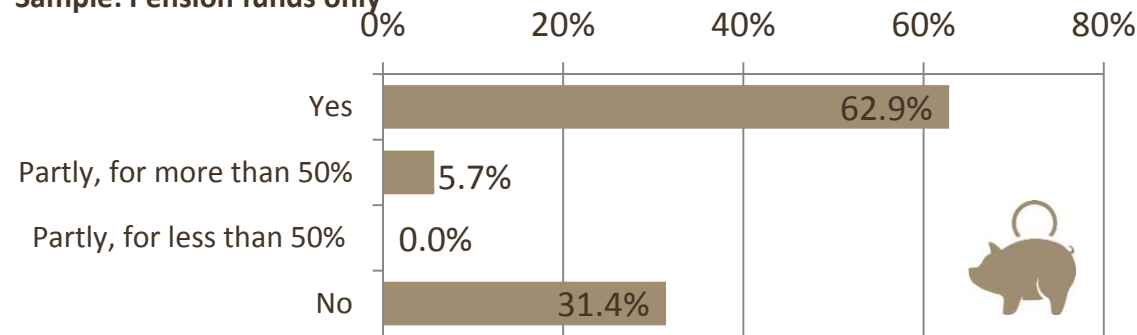
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Voting rights (I/II)

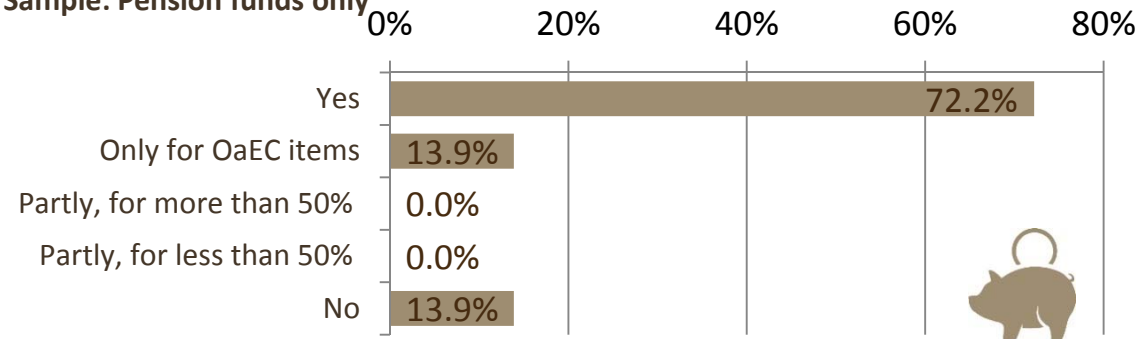
Active use of voting rights for equity positions prior to the OaEC

Sample: Pension funds only



Active use of voting rights for equity positions after the OaEC

Sample: Pension funds only



- About a third of the responding pension funds have not made use of their voting rights prior to the OaEC
- About half of the pension funds (14% of the respondents) that have not made use of their voting rights so far will continue to do so

Question I: Did your organisation generally actively use its voting rights (equity positions Switzerland) at the annual general meetings prior to the ratification of the OaEC? (i.e.: abstention from voting was the exception)

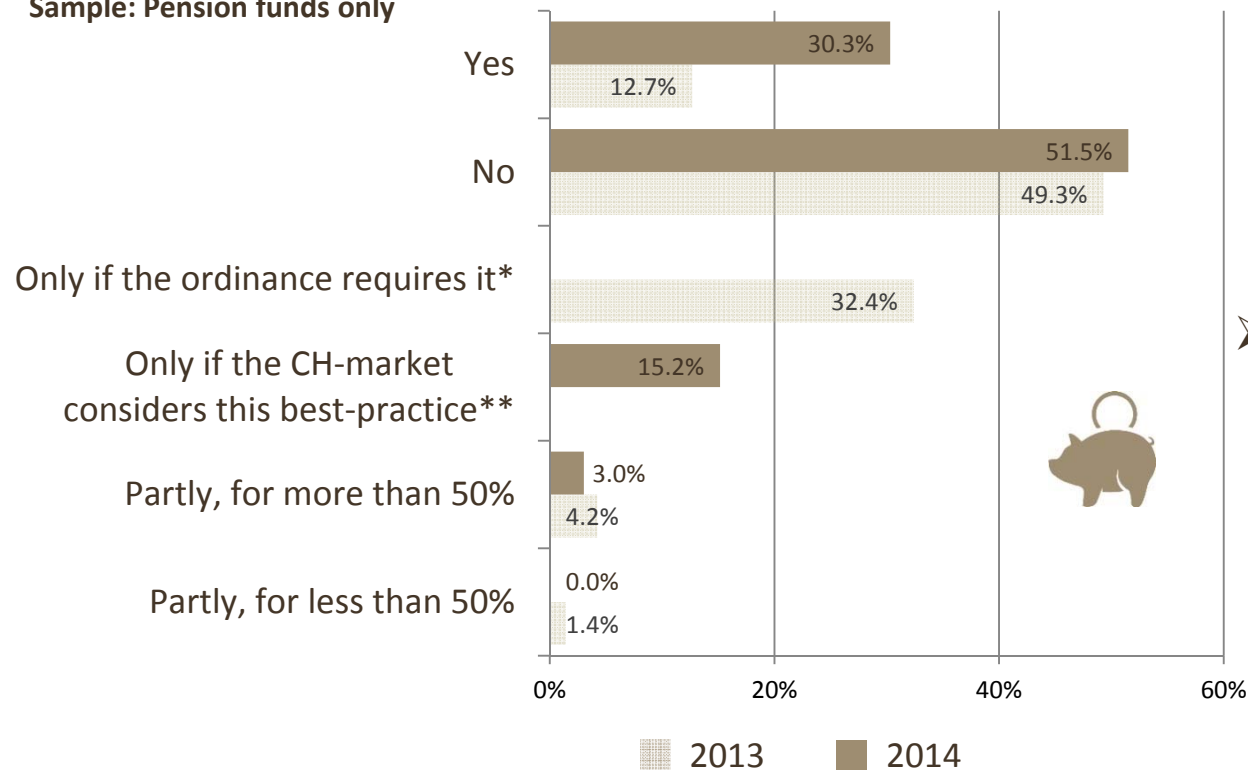
Question II: Does your organisation plan to generally actively use its voting rights (equity positions Switzerland) for direct investments after the OaEC is fully implemented (January 1st, 2015)? (i.e.: abstention from voting will be the exception)



Voting rights (II/II)

Active use of voting rights for indirect investments after OaEC

Sample: Pension funds only



- The share of pension funds that plans to make active use of its indirect voting rights has increased markedly since last year
- But more than 50% of the respondents still do not plan to actively exercise the voting rights on their indirect investments

Question: Does your organisation plan to generally actively use its voting rights (equity position Switzerland) for indirect investments after the OaEC is fully implemented (January 1st, 2015)? (i.e.: abstention from voting will be the exception)

* Answer only available in survey 2013

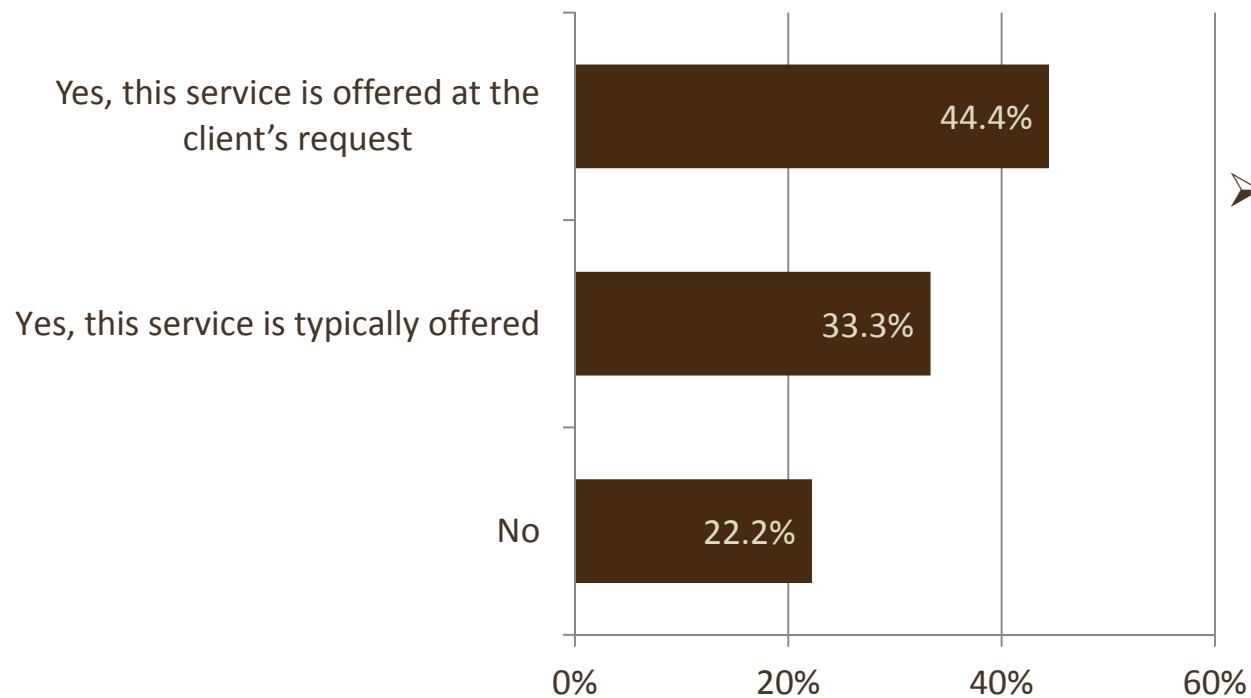
** Answer only available in survey 2014



Indirect investments

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

Sample: Asset managers only



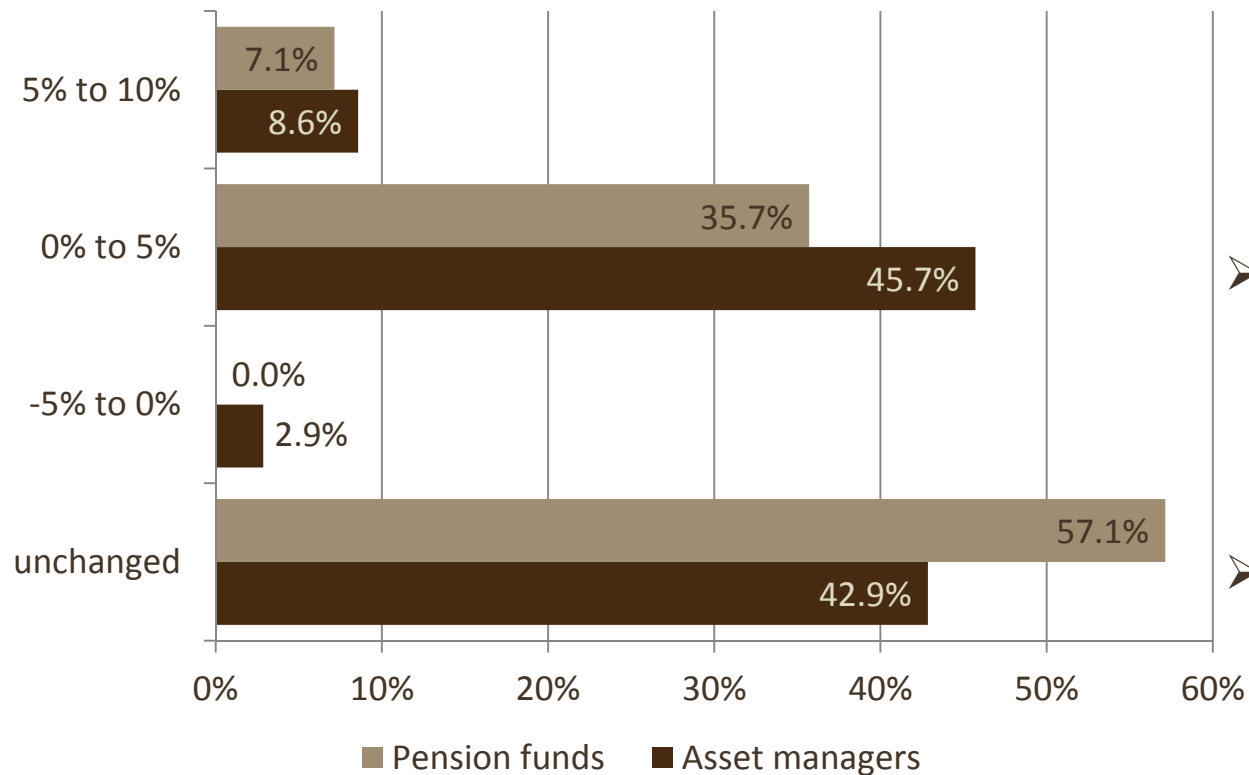
- A third of the responding asset managers already offer the possibility to vote proxies to its clients
- The majority of the responding asset managers are willing to provide this service

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



Administrative costs

Expected impact of the OaEC on the administrative costs



- More than 50% of the responding pension funds believe that the OaEC does not increase the administrative costs
- Fewer than 10% of pension funds and asset managers expect a cost increase of 5-10%
- The answers are consistent with last year's replies

Question: What is the expected impact of the OaEC on the administrative costs of your organisation (change in % compared to 2012, the year prior to the ratification of the OaEC)?



Insights: Investor behavior

- Pension funds seem divided on how voting rights should be exercised
 - A growing number of pension funds intends to exercise their voting rights for indirect investments
 - Some pension funds plan to entirely abstain from voting
- Asset managers seem prepared to offer their clients the possibility to vote proxies
- In SWIPRA's view, the right to vote at AGMs has a value that institutional investors should try to unlock



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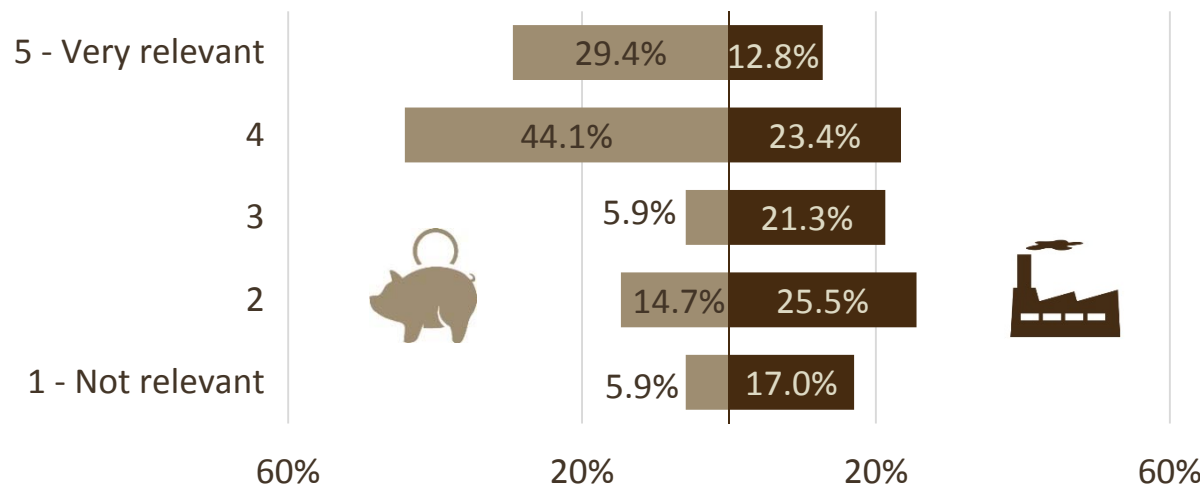
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Pay-for-performance



Comparison between achievement level of performance targets and resulting payout of variable compensation



- Institutional investors perceive a transparent pay-for-performance disclosure as highly relevant
- Issuers seem to have no strong opinion on the importance of pay-for-performance disclosure

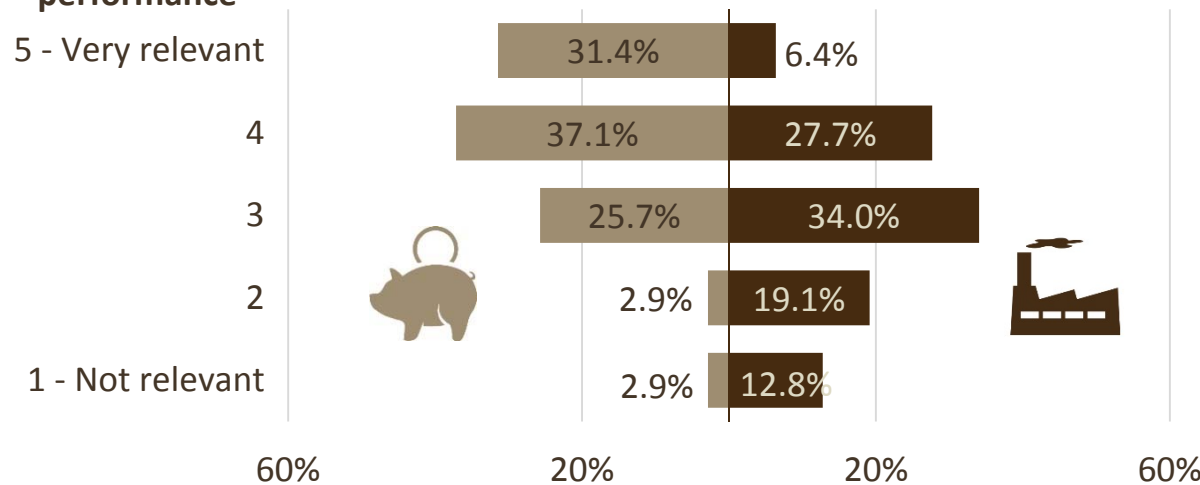
	Pension funds	Asset managers
5 - Very relevant	18.2%	50.0%
4	50.0%	33.3%
3	4.5%	8.3%
2	18.2%	8.3%
1 - Not relevant	9.1%	0.0%

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 level of the compensation relevant performance targets and the resulting payout of variable compensation elements.



Incentives

Separation of compensation elements that reward for past performance and those that set incentives future performance



- Institutional investors, and in particular asset managers, want issuers to clearly delineate which period a given compensation element refers to
- Issuers have no strong opinion on this differentiation and consider it less relevant than last year

	Pension funds	Asset managers
5 - Very relevant	21.7%	50.0%
4	39.1%	33.3%
3	30.4%	16.7%
2	4.3%	0.0%
1 - Not relevant	4.3%	0.0%

Question: Certain companies publish the following items in detail in their compensation reports. How relevant are, in your opinion, these items?

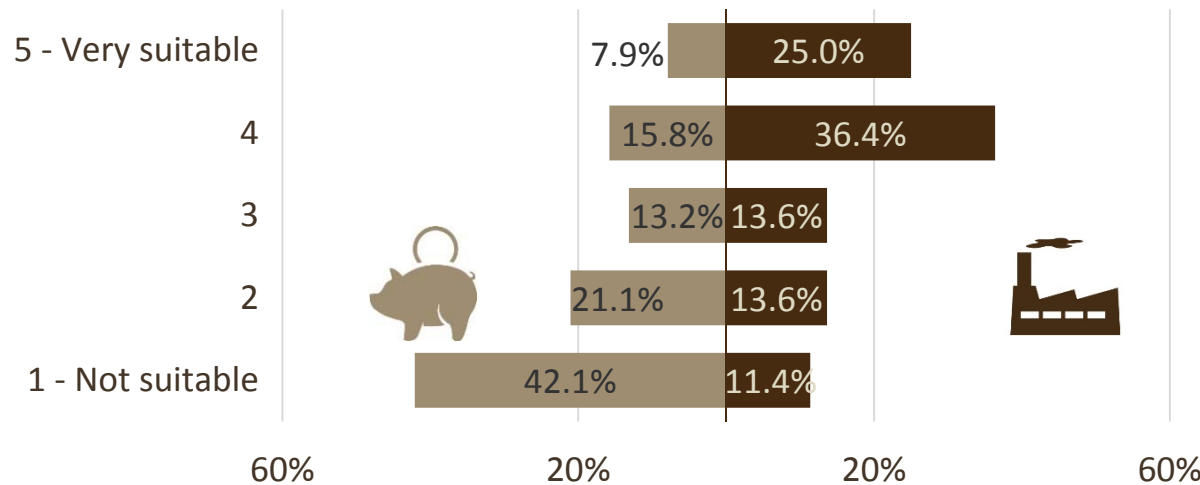
- Explicit separation of compensation elements that reward the individual for past performance and compensation elements that set incentives for an individual's future performance.



KPIs: Adjusted profit



Adjusted profit, i.e., profit that does not reflect extraordinary items such as fines, mergers, etc.



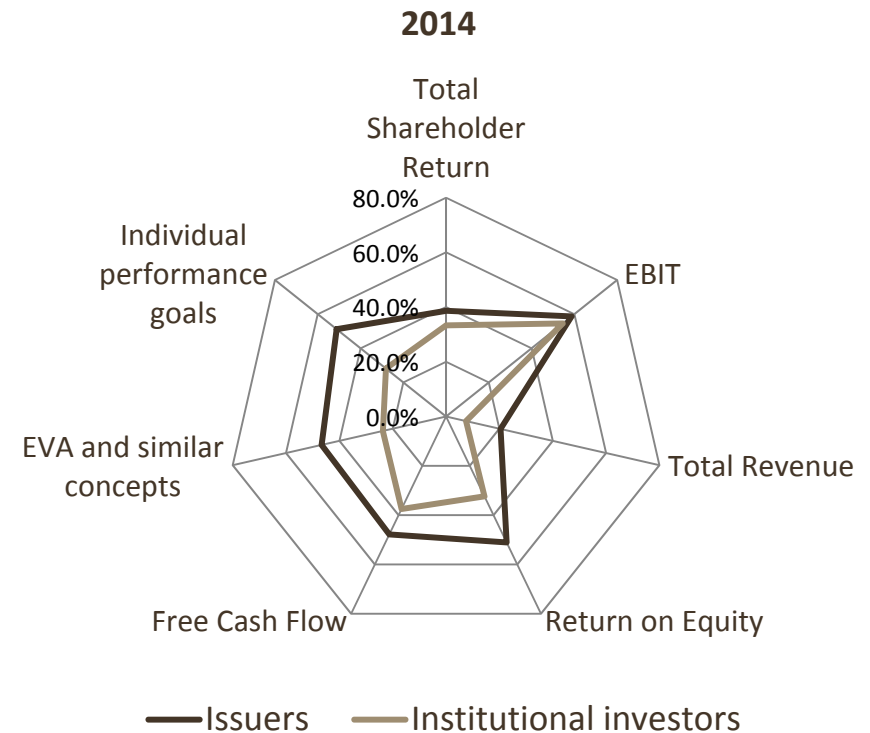
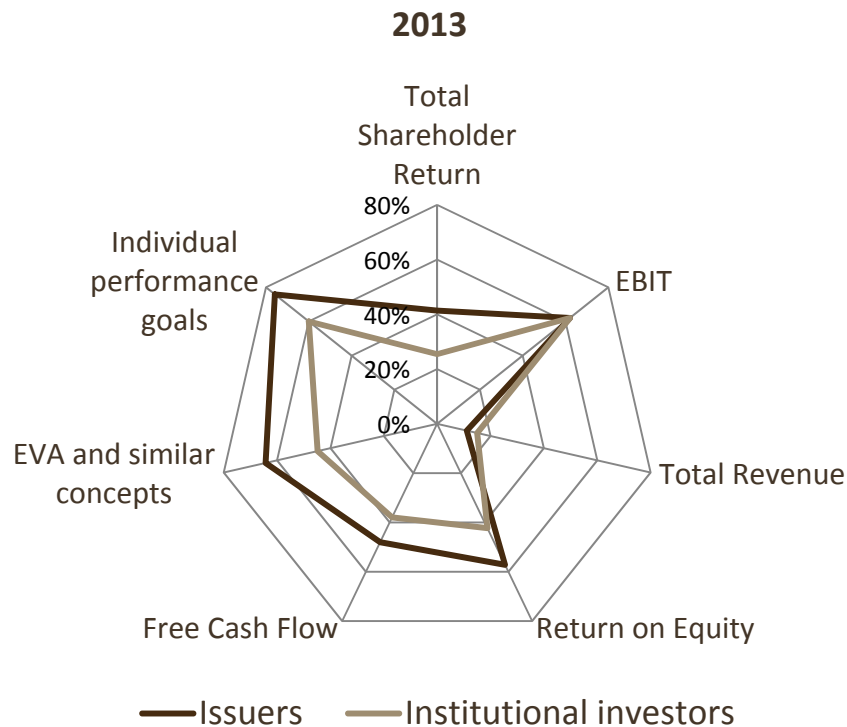
- More than 60% of the surveyed issuers believe that adjustments are a suitable performance measure
- Institutional investors share the distinct opinion that adjusted performance measures are inadequate KPIs

	Pension funds	Asset managers
5 - Very suitable	12.5%	0.0%
4	16.7%	21.4%
3	8.3%	21.4%
2	29.2%	7.1%
1 - Not suitable	33.3%	57.1%

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.



KPIs: Overview



➤ **There seems to be no “best practice” for KPIs**

Remark: The chart shows the percentage of the institutional investors and issuers who found the corresponding performance measure suitable or very suitable.

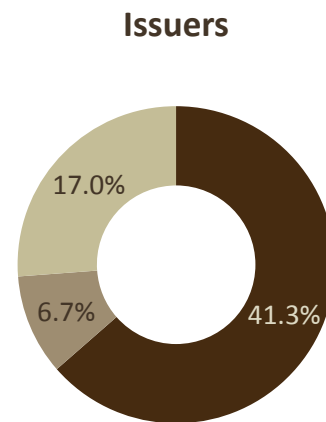
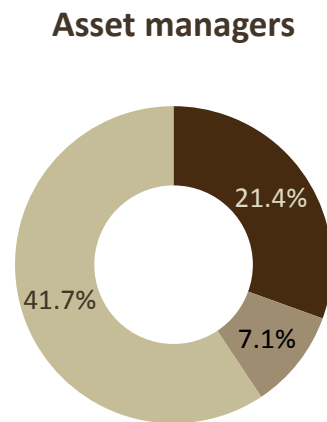
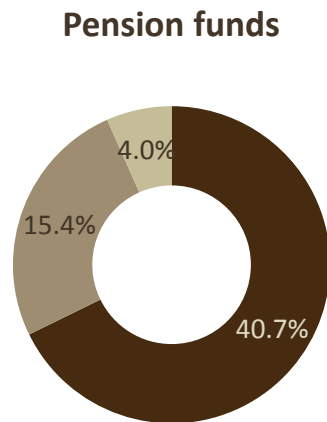


Compensation structure



The largest weights within the executive management compensation mix

➤ The majority of issuers and pension funds assign the largest weight within the compensation mix to base compensation



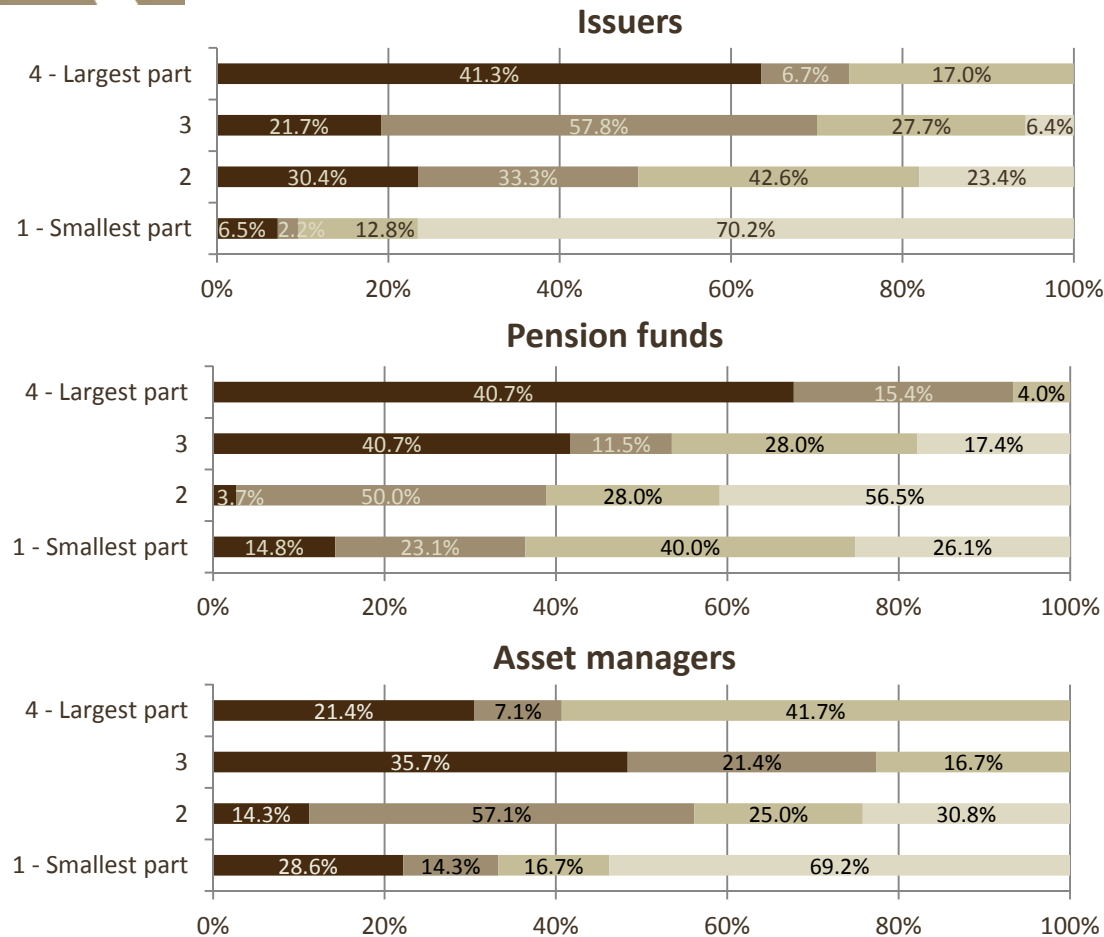
➤ Asset managers assign the largest weight within the compensation mix to equity-based long-term compensation elements

- Non-variable compensation in cash
- Variable compensation in cash or equity
- Equity-based prospective compensation

Question: Please indicate which compensation items should be the most important component of total compensation for the executive management.



Compensation structure



- Issuers put a greater weight on the share of *short-term* performance related compensation in the total pay mix than institutional investors
- The share of forward-looking *long-term* compensation in the total pay mix is considered as substantially less important by issuers and pension funds than by asset managers

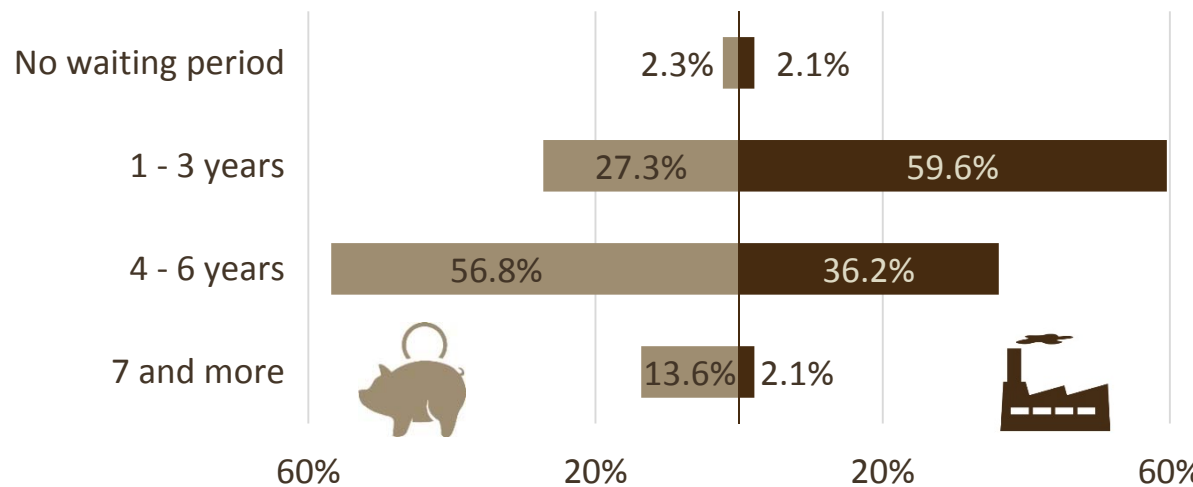
Question: Please indicate which compensation items should be the most important component of total compensation for the executive management.

- Non-variable compensation in cash
- Variable compensation in cash or equity
- Equity-based prospective compensation
- Contributions to pension plans that exceed the legally required payments



Blocking periods

After how many years should shares and stock options (prospective compensation components) be released?



	Pension funds	Asset managers
No waiting period	3.3%	0.0%
1 – 3 years	20.0%	42.9%
4 – 6 years	60.0%	50.0%
7 and more	16.7%	7.1%

- Consistent with a long-term perspective, pension funds have a preference for longer blocking periods
- Asset managers are neither strongly short-term nor strongly long-term oriented
- Both issuers and investors have become less long-term oriented compared to last year's survey

Question: One possibility to create long-term incentives is the ownership of equity in the company. After how many years should shares and stock options (prospective compensation components) be released?



Insights: Compensation (I/II)

- Pay-for-performance is a hot issue for institutional investors and other stakeholders, and there is a significant expectations gap between issuers and institutional shareholders regarding the expected disclosure
- Most compensation systems contain some elements that reward for past performance and other elements that provide incentives for future performance. In SWIPRA's view, a clear distinction between the two types of reward components is important, also for say-on-pay votes



Insights: Compensation (II/II)

- There are also gaps in terms of what issuers and institutional investors regard as suitable key performance indicators and as suitable compensation structures
- SWIPRA Policy Considerations: Focus on value generation. One system does not fit all



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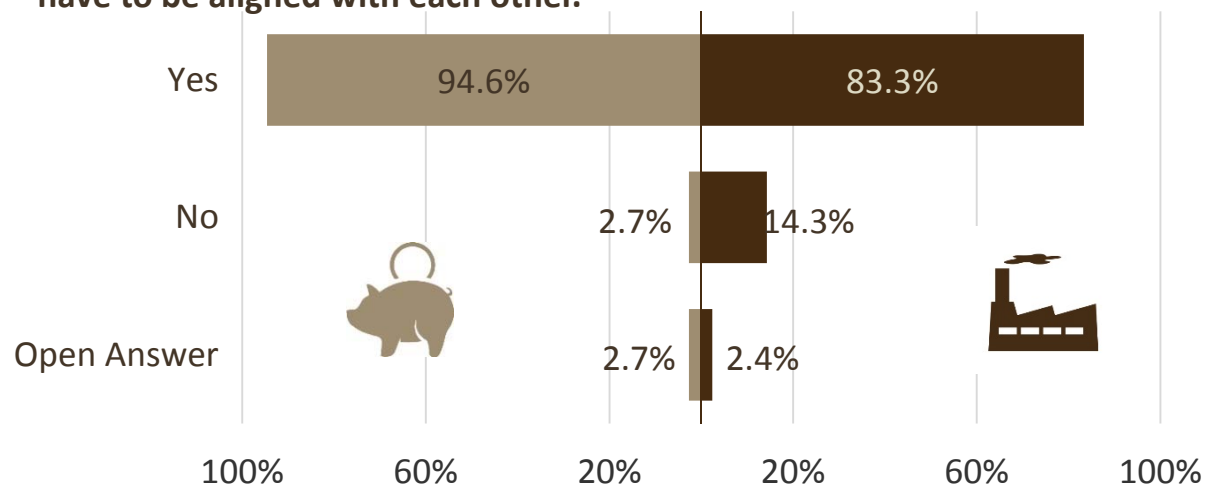
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Voting regimes (I/IV)



Structure of the compensation system and the compensation-voting regime (prospective / retrospective) have to be aligned with each other.



- All surveyed groups agree that there needs to be a “fit and match” between compensation systems and voting regimes

	Pension funds	Asset managers
Yes	92.0%	100.0%
No	4.0%	0.0%
Open Answer	4.0%	0.0%

Question: The structure of the compensation system (in particular the relative importance of the base salary, the short-term bonus and the long-term share-based compensation) and the compensation-voting regime (prospective / retrospective) have to be aligned with each other.



Voting regimes (II/IV)

- *Pension funds and asset managers:*
Suppose your pension fund / asset management holds shares of company A. At the next annual general meeting, your organization has to vote on company A's amendment to its articles of association related to the compensation voting regime.
- *Issuers:*
Suppose that you can pick the compensation-voting regime for company A.
- Company A has the following compensation system in place for its executive management (in the following presented for its CEO):
 - Fixed base compensation: The CEO receives a fixed base compensation of 100 in cash.
 - Variable compensation: [see next page]



Voting regimes (III/IV)

The following information is provided with regards to the variable compensation:

➤ Information 1:

Depends on the company's total shareholder return (TSR) during the past financial year relative to the median TSR of a peer group.

➤ Information 2:

(a) TSR of 5% above the peer group median (target) results in a variable compensation of 100.

(b) TSR of 15% or above the peer group median results in a maximum possible variable compensation of 200.

(c) TSR of (5%) or less relative to the peer group median results in compensation of 0 (floor).

(d) Variable compensation is linear, i.e. for each percentage point additional relative TSR, variable compensation increases by 10.

➤ Information 3:

The relation between relative TSR and variable compensation is disclosed annually. In the past year, company A's TSR was 7% above the peer group median. This leads to a variable compensation for the CEO of 120.



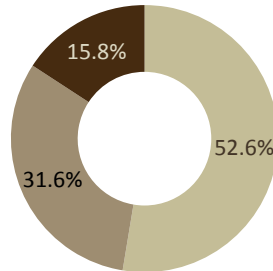
Voting regimes (IV/IV)



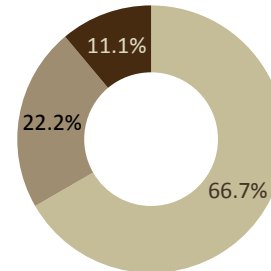
Which voting regime would you prefer for the variable compensation?

...if information 1 to 3 are disclosed

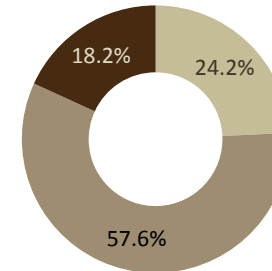
Pension funds



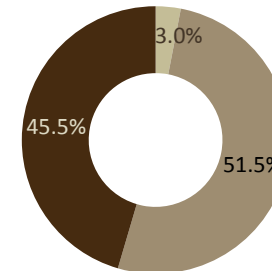
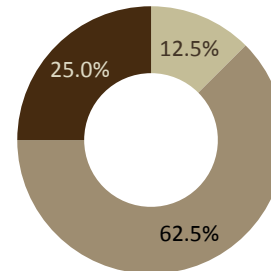
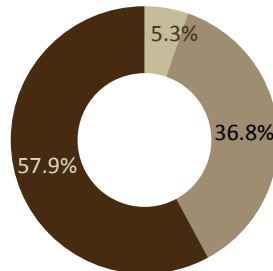
Asset managers



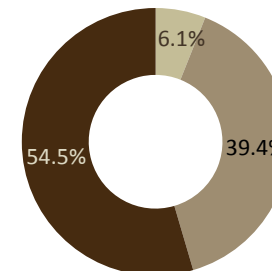
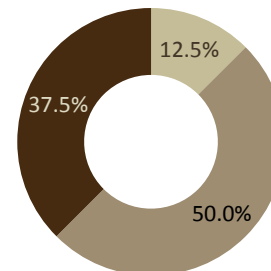
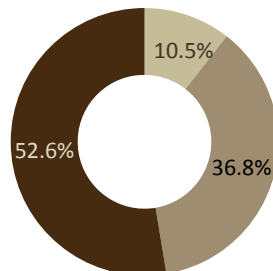
Issuers



...if detailed information about the relation between relative TSR and variable compensation (information 2) is missing



...if detailed information about the maximum possible payout of the variable compensation element (information 2b) is missing



Prospective binding

Prospective binding with a retrospective advisory vote on compensation report

Retrospective binding for the past year



Insights: Voting regimes



- Prospective votes require a more comprehensive disclosure than retrospective votes
- Advisory retrospective votes are seen as a possible partial substitute for providing detailed ex-ante information for prospective votes
- Pension funds and issuers are quite well-aligned in their views, while asset managers are rather critical on retrospective votes
- SWIPRA infers that shareholders wish to have the relevant information on the issues they are asked to vote on



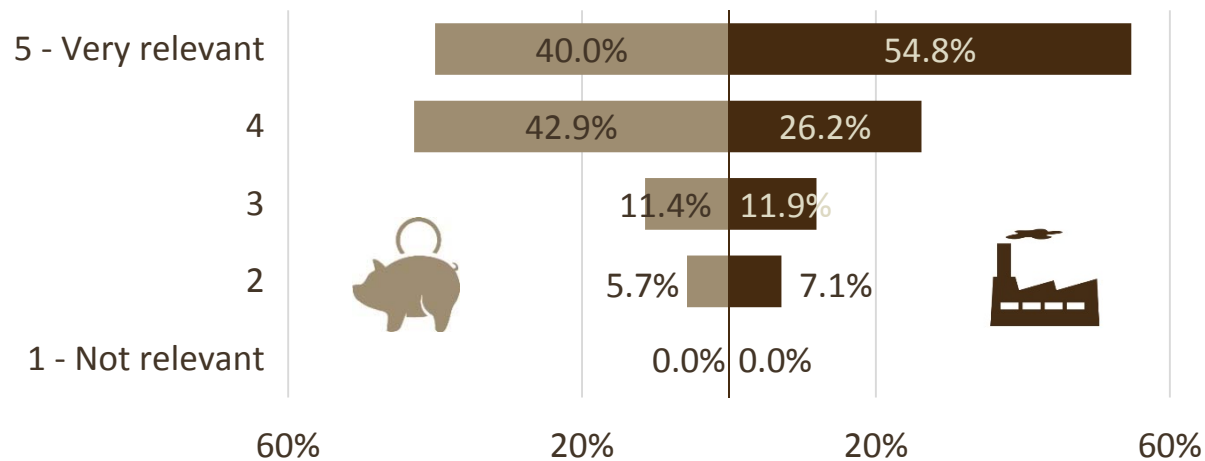
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Board composition (I/II)

Augment the diversity of professional knowledge of the Board



- Institutional investors and issuers have a shared understanding that each member of the Board should contribute specific knowledge
- Answers are similar to last year's survey

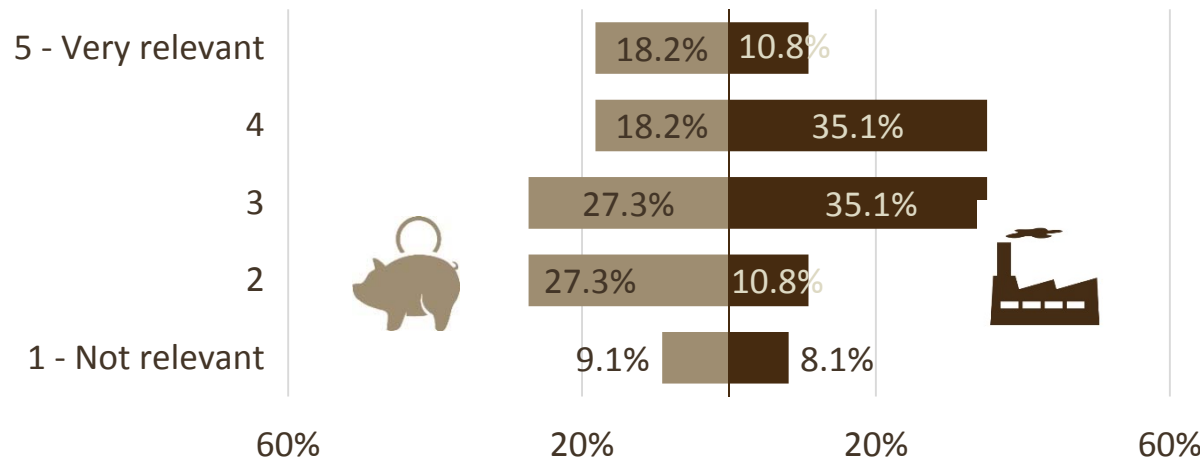
	Pension funds	Asset managers
5 - Very relevant	39.1%	41.7%
4	47.8%	33.3%
3	8.7%	16.7%
2	4.3%	8.3%
1 - Not relevant	0.0%	0.0%

Question: Please indicate the relevance of the following factors in determining the fit of a prospective member of the Board of Directors:
 - Augment the diversity of professional knowledge of the board



Board composition (II/II)

Augment the personal diversity of the Board (country of origin, ethnos, gender, age)



- Personal diversity is not very important for institutional investors and only marginally more important for issuers
- Issuers consider it somewhat less relevant than last year when 66.6% considered it (very) relevant

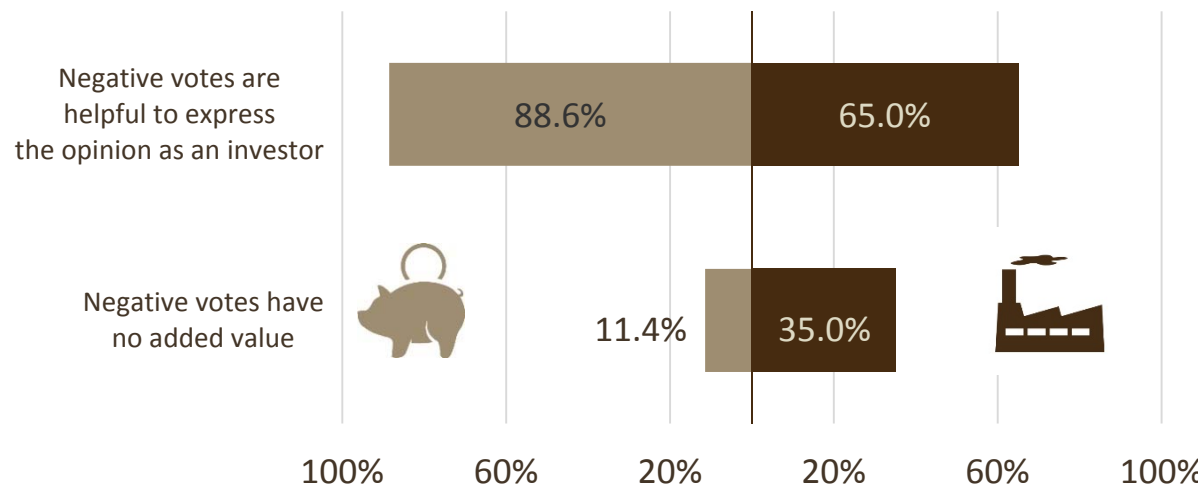
	Pension funds	Asset managers
5 - Very relevant	19.0%	16.7%
4	19.0%	16.7%
3	28.6%	25.0%
2	28.6%	25.0%
1 - Not relevant	4.8%	16.7%

Question: Please indicate the relevance of the following factors in determining the fit of a prospective member of the Board of Directors:
 - Increase of the personal diversity of the board (country of origin, ethnos, gender, age)



Discharge

How useful are negative shareholder votes regarding the discharge of the Board?



	Pension funds	Asset managers
Neg. Votes are helpful	91.3%	83.3%
Neg. Votes have no added value	8.7%	16.7%

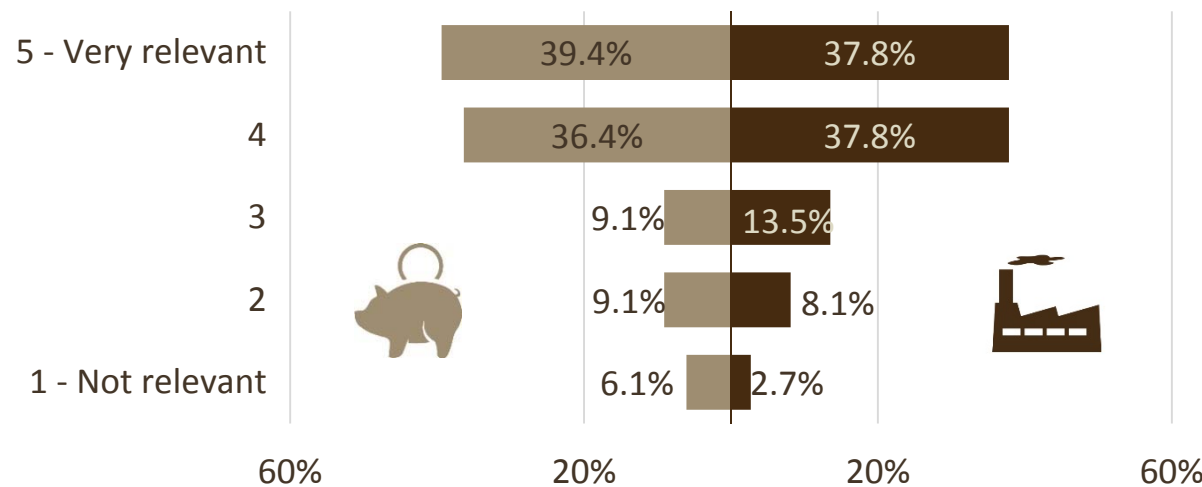
- There is a shared understanding that negative discharge votes are a valid instrument to voice discontent with decisions of the company's management and/or Board
- The results are consistent with the findings in last year's survey

Question: Discharge / Exoneration: Investors predominantly grant the discharge of the Board of Directors. However, negative votes are sometimes used to express the dissatisfaction with the current Board of Directors. What is your opinion regarding these negative shareholder votes?



Capital increase

Dilution of earnings per share



	Pension funds	Asset managers
5 - Very relevant	42.9%	33.3%
4	42.9%	25.0%
3	4.8%	16.7%
2	9.5%	8.3%
1 - Not relevant	0.0%	16.7%

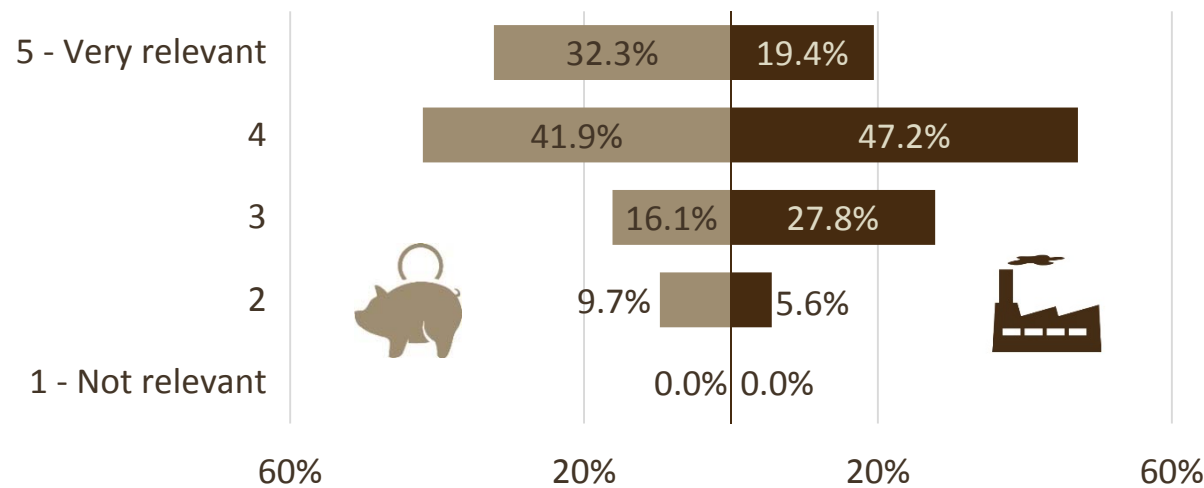
- Institutional investors and issuers agree that the dilution of earnings per share should be considered carefully when new equity capital is raised
- The outcome is similar to last year's results, with the awareness of institutional investors increasing

Question: Please indicate the relevance of the following items when considering the decision to increase equity capital:
 - Dilution of earnings per share



Payout policy

Relevance of disclosure of a specific payout policy



➤ *Disclosed* payout policies are seen as (very) relevant by institutional investors and issuers alike

	Pension funds	Asset managers
5 - Very relevant	21.1%	50.0%
4	52.6%	25.0%
3	15.8%	16.7%
2	10.5%	8.3%
1 - Not relevant	0.0%	0.0%

Question: How relevant would you deem the disclosure of a specific payout policy (e.g. 50% of net profits are paid out)?



Insights: Other results

- Issuers should actively disclose information on specific knowledge of each member of the Board
- It is important for issuers to not only have a payout policy in place, but also to disclose it to their shareholders
- To avoid negative consequences of failed discharge votes it is important to issuers to have an ongoing dialogue with its shareholders
- In SWIPRA's view, improved value reporting can help generate value



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Summary and outlook

- Swiss listed companies and institutional investors (pension funds and asset managers) approach the annual general meeting (AGM) season 2015 with partially diverging expectations
- SWIPRA's experience as a critical information intermediary between issuers and shareholders has been very positive in 2014
- A deeper exchange between investors and issuers as well as a more active engagement by institutional investors are necessary in order to further improve corporate governance in Switzerland



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