Newsletter 06/2022

SWIPRA Review AGM Season 2022

Learnings form the Swiss AGM Season 2022:

More women directors, higher management compensation, unexplained ESG compensation criteria and more pressure on boards

Zurich, June 30th, 2022 – Elections of board members account again for the majority (67%) of the most contested agenda items during the Swiss AGM Season 2022. The focus was particularly on directors' individual roles, such as board or committee chairs. Nomination committee chairs of companies with fewer than 30% women board members received more than twice as many AGAINST votes. This concerns 5 SMI (2021:11) and 51 (2021: 64) non-SMI companies. The average female board representation reached 28.5% for SPI100 companies (34.4% in SMI companies, breaking the 30% hurdle for the first time, and 27.0% in non-SMI companies). CEO compensation levels increased by 27.3% in SPI100 companies on average, driven by higher bonus payments, whereas the multiple of CEO to average employee pay ("Pay ratio") increased from 24.4x to 29.9x. The fraction of SPI100 companies including ESG-indicators in executive compensation increased from 24% in 2021 to 47%, but these criteria remain unexplained in close to 60% of the cases. Globally, investors' and proxy advisors' scrutiny in assessing sustainability reports or policies increased, leading to levels of AGAINST votes more than twice as high as in previous years. Past AGM outcomes may thus be a bad predictor for coming sustainability votes in Switzerland. More Non-SMI companies reported in line with the GRI (62%, up from 52%) and CDP standards (30%, up from 14%), while TCFD only gained followers amongst SMI companies (85%, up from 65%). The consultation process on the Federal Council's ordinance to introduce TCFD as a mandatory standard for climate reporting is still ongoing. However, there is apparently little support for the TCFD standard amongst non-SMI companies.

Next Events

Cooperation-Partner of SWIPRA Services

Review AGM Season 2022
Webinar
July 6, 2022

SWIPRA Corporate Governance Survey 2022
Presentation of key findings
End of November 2022

Board of Directors

- In elections, individual board members are increasingly held accountable by investors for their performance in specific functions such as audit, nomination, compensation or board chair
- Nomination chairs received more than twice the number of AGAINST votes if women's representation on the board was below 30%
- Average female board representation reached 28.5% (up from 25.4%) for the SPI100 and exceeded the 30% hurdle for the first time in SMI companies (34.4%, up from 29.6%)

Board members who received more than 20% AGAINST votes were not supported mainly due to independence (57% versus 60% in 2021) or availability/overboarding concerns (33% versus 24%). These factors are considered particularly important by shareholders for directors with special responsibilities such as committee or board chairs to establish a well-functioning governance. They are under increased scrutiny and receive lower approval rates in general.

Absent anchor shareholders votes (strategic investments), several audit, nomination or compensation committee chairs would not have made their election in the AGM season 2022 as a majority of institutional and minority shareholders voted against them. Nomination committee chairs were under particular scrutiny in 2022 due to women representation on the board, receiving 17.4% (median, excl. anchor shareholders) and up to 50.6% (25% most contested cases) AGAINST votes in case less than 30% of their board was female (compared to 4.3% (median) for above 30%). This was the case in 5 companies in the SMI (down from 11 last year) and 51 companies in the SPI100 (down from 64).

Despite the joint responsibility of a Swiss board from a legal perspective, it is important for board members to realize that they are increasingly held accountable on an individual basis, not just on peculiarities such as age, tenure, independence, or availability, but also on how they manage the company.

Compensation

- CEO total compensation levels (median) increased by 25.2% for SMI (CHF 7.6m) and 7.1% for non-SMI (CHF 1.8m) companies
- The high STI payout levels led to a 22.4% increase of the average multiple of Total CEO pay to average employee pay from 24.4x in 2021 to 29.9x in 2022
- 47% of SPI100 companies included ESG in their compensation plans, but 58% did not explain what these ESG measure are, how they are measured, and how they impact compensation levels

Following a year of compensation decisions under the “shared burden”-label, during which 52% of the SPI100 companies reduced their total CEO compensation (financial year 2020), the financial year 2021 saw 74% of companies increasing CEO pay levels, mainly driven by higher bonus payouts. Companies with the largest pay increases compared to last year (+40.7% on average) were also those that had reduced their pay package the most during the pandemic (-18.6%). Overall, shareholders were appreciative of the pay-performance levels in the financial year 2021 as compensation reports AGAINST votes decreased from 14.3% to 12.5% (median).

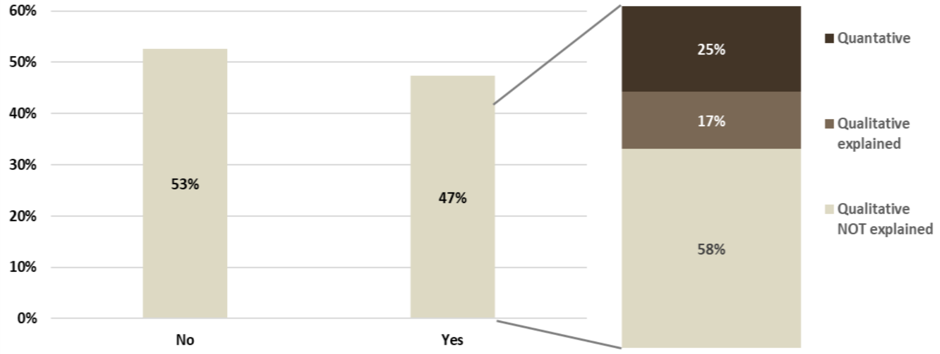
The binding votes on compensation amounts continue to be used very rarely by shareholders to voice discontent, though levels of AGAINST votes continued to increase from 4.0% in 2018 to 5.7% in 2022. Scrutiny on compensation levels is expected to increase further, not least because the multiple between the CEO’s total compensation and the average pay per employee (“pay ratio”) for SPI100 companies increased from an 24.4 in 2020 to 29.9 in 2021 (average), indicating that the CEOs overall pay levels have increased more in 2021 than those of the average employees. This will likely resonate in upcoming investor-company engagements, together with how ESG is anchored in companies’ compensation plans.

47% of the SPI100 companies indicated in their compensation report that they have an “ESG”-performance metric included in their variable executive compensation. Yet, 58% of these companies do not provide an explanation of how they measure ESG performance and how this impacts compensation levels. If such ESG criteria remain unexplained, they are likely to undermine investors’ trust in a company’s compensation system and ESG philosophy. Only 25% use a traceable quantitative measure, such as CO_2-emissions or injury rates, to incorporate ESG in their compensation plans.

ESG voting behavior and reporting

- Globally, the support for shareholder-sponsored ESG proposals increased
- The number of SPI100 companies reporting according to GRI (70%) and CDP (42%) standards increased, while TCFD was only picked up by SMI companies
- 66.7% of SMI and 20% of Non-SMI companies signed-up to the science-based targets initiative (SBTi) and committed to short, medium and long-term CO_2-reduction targets

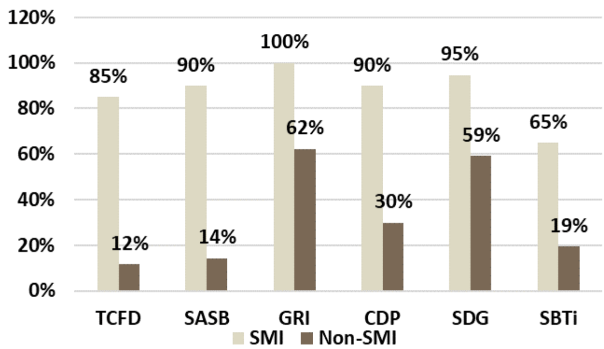
Figure 1: ESG-Criteria in the compensation systems of SPI-100 companies



As indicated in the SWIPRA AGM Outlook 2022, many institutional investors and proxy advisors have amended their ESG proxy guidelines with respect to ESG, which increased their scrutiny of sustainability reports. This shows in their voting behavior: Around the globe, in particular in the UK and Spain, the AGAINST fraction on sustainability reports (total of 28 votes) increased from 2.5% to 10.3% and for sustainability policies (total of 25 votes) from 3.8% to 10%. For ESG-related agenda items, past voting outcomes are obviously a bad prediction of future outcomes. Swiss companies should keep this in mind when preparing their Say-on-Sustainability votes for 2024, but also when anchoring ESG in their compensation policies (as indicated above). These are important reputational factors for any company to watch.

During the financial year 2021, the number of companies reporting according to the Global Reporting Initiative (GRI) standard has increased again, in particular the share of non-SMI companies increased from 52% to 62% (all SMI companies provide a GRI-report). The number of companies providing a CO_2-focussed CDP report grew considerably amongst non-SMI companies (from 14% to 30%), while remaining high for SMI companies (90%, up from 85%). Yet, companies reporting according to the Task-force on Climate-related Financial Disclosure (TCFD) standard only increased in the SMI segment (from 65% to 85%), not least because substantial institutional investors started to vote against the election of the board chair if no TCFD-report was provided. Only 12% (unchanged) of the non-SMI companies provide a TCFD report. The current regulatory trajectory is not reflecting this market development. It is questionable, whether the additional benefit can justify the significant effort required to establish such a full-fledged TCFD report across a wide range of companies as the currently planned regulation in Switzerland foresees. However, TCFD, and only this standard, would be provided for by the Federal Council's ordinance on climate reporting. This is currently in the consultation process.

Figure 2: Use of ESG-reporting standards 2022



At the same time, already 65% of SMI companies and 19% of non-SMI companies have or are in the process of approving their CO_2-reduction paths aligned with the goals of limit global warming at 1.5°C or 2°C by the Science-based Targets initiative (SBTi). These companies have clear targets on when and how they must reduce their CO_2-emissions and against which they can be assessed and held accountable.

Proxy Advisors

- The estimated impact on AGM voting outcomes has become smaller for all proxy advisors but ISS, which is estimated to move around 10-15% of the votes on average
- Similar to investors, proxy advisors have become more sophisticated in scrutinizing ESG proposals and are also increasingly targeting board members with specific board functions, depending on the situation

Proxy advisors continue their change of role from entities fully determining the voting behavior of their customers to research providers, which their customers use as a basis to develop their voting decisions. This not only shows in the increasingly individualized proxy policies, but also in the influence assessment. During the AGM season 2022, all proxy advisors but ISS dropped in influence. ISS increased to the level of 2020, and was able to move around 12.5% of SPI100 votes on average (independently from other proxy advisors).

Likewise, despite an ISS “FOR” recommendation on the compensation report, one out of four companies received on average 20.8% AGAINST votes. If ISS recommended “AGAINST” in a board election, it is still possible that the candidate receives 98% votes in favor. Both examples show that deviations from proxy advisor policies are possible and can potentially lead to significantly different outcomes than one would expect just from looking at proxy advisor recommendations. Also here, the past may not be the best predictor of the future and shows the ever-increasing importance of a thorough stakeholder management.

AGM participation and organization

- Shareholder voting participation remained largely unchanged compared to pre-Corona levels

- The majority of AGMs in 2022 took place without physical shareholder presence (Covid-regime), but few companies have amended their articles of association yet to allow for hybrid or virtual formats going forward
- A higher fraction of companies allowed for an exchange with their shareholders ahead of the virtual AGM

The fraction of shareholders casting their votes, electronically or physically, at AGMs has remained largely unchanged compared to previous years (69.5% for SPI100 companies). Notably, the Corona pandemic did not have an impact on shareholders' commitment to vote, in particular for institutional investors. This also aligns with findings of the SWIPRA Survey 2021. In the third (and final) year under the official Swiss Corona-AGM regime, companies have also improved on the non-physical AGM experience of their shareholders, with 87% of SMI companies having provided the possibility to shareholders to explicitly ask questions prior to the AGM and 85% providing them with a webcast. It remains to be seen which AGM format will develop as the preferred standard following the new corporate law being effective by 2023.

On the SWIPRA's AGM analysis 2021/2022

SWIPRA, together with researchers from the Institute of Banking and Finance at the University of Zurich, analyzed the results of the AGMs of the 100 largest listed Swiss companies held between July 1, 2021 to June 14, 2022. ISS recommendations are not publicly available and are approximated by market observations. Data on international developments was obtained from Insightia. The overall analysis contains more data than described here. For further information, please contact SWIPRA.

SWIPRA's Services

↗ Service Packages

↗ Board Assessments & Advice

↗ Governance, CSR & Engagements

↗ IPO readiness & Transactions

SWIPRA & KPMG joint ESG services

About SWIPRA Services

SWIPRA Services provides **corporate governance and corporate social responsibility services** for listed companies and their boards of directors. We provide our clients with hands-on advice that takes into consideration relevant stakeholder opinions with 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

SWIPRA Services is working with a high-profile think tank to further develop corporate governance and CSR in Switzerland.

Contact

Barbara A. Heller, Managing Partner, T: +41 (0) 55 242 60 00, E: barbara.heller@swipra.ch