ADVESTRA INSIGHTS

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# A closer look at the AGM season 2023: Proxy Advisors and their revised Guidelines

**While the focus of this annual general meeting (AGM) season is very much on the changes of the articles of association as a result of the Swiss corporate law reform, it is nevertheless important for Swiss listed companies to consider the amendments proxy advisors suggest for this AGM season. This Insight presents some of the changes to their recommendations, which are typically of relevance for Swiss listed companies.**

## 1 INTRODUCTION

Proxy advisors do not rest when it comes to a new AGM season and the possibility to amend their existing policies for voting recommendations for listed companies. In this regard, this year is in line with this tradition: The main proxy advisors provided each a new set of proxy guidelines. In contrast to previous years, the changes in these proxy guidelines are quite heterogeneous with a variety of changes.

Listed companies face multiple challenges this year: Not only proxy advisors amended their rules, but also the Swiss corporate law reform entered into force on 1 January 2023. It requires Swiss listed companies to propose amendments to their articles of association either at this AGM or at the AGM of next year. On top, economiesuisse provided a new Swiss Code of Best Practice.

We limit this Insight to the amendments of proxy guidelines and picked a few changes from three dominant proxy advisors in Switzerland, being ISS, Glass Lewis and Ethos, and provide a short summary of some of the main amendments without being exhaustive.



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We focus in this Insight on four main topics:

(i) Governance;
(ii) ESG and ESG reporting;
(iii) Corporate law reform: capital authorization and changes of the articles of association; and
(iv) Compensation.

## 2 GOVERNANCE

Not surprisingly, governance of Swiss listed companies remains a hot topic for proxy advisors. Although the majority of the principles laid out in the guidelines were not amended, some of the changes are worth highlighting.

The definition of independence of board members was modified and refined lightly in the *ISS* guidelines: ISS makes it clear that a former executive director who joins the board without having completed a five-year cooling-off period will be classified as non-independent for the remainder of his/her tenure on that board. Hence, a board member may not "cure" his/her cooling-off period over time but will be subject to a negative recommendation throughout his/her tenure as a board member by ISS. Interestingly, ISS also specifies for the first time that sponsors of special purpose acquisition company (SPAC) are not considered independent when elected to the board of the relevant SPAC. In the view of ISS conflicts of interests may arise where the interests of a SPAC sponsor and shareholders are misaligned, in particular as a result of special rights of classes of shares held by sponsors. In Switzerland, the importance of this change is limited given that only one company is listed as a SPAC on SIX Swiss Exchange.

*Ethos* reduced the maximum term of a board member from 20 to 16 years. As a result, board members who wish to serve longer than 16 years must provide a compelling reason for another tenure to prevent Ethos from issuing a recommendation to vote against such board member. As *ISS* and *Glass Lewis* set the maximum terms at 12 years, the change of Ethos to reduce the maximum term does likely not impact subject companies. Further, a board member who was a member of a national or regional government in the past 12 months does not qualify as independent according to Ethos' updated guidelines.

In terms of diversity, neither ISS nor Glass Lewis or Ethos made any changes. Nevertheless, there remains a vocal demand for more diversified boards: Boards should have at least 30 percent of the underrepresented gender (typically women) failing which a negative recommendation will be issued for the chair of the nomination committee. In case of non-compliance with this threshold, ISS expects a firm public commitment from companies to comply with the standard within one year. A lower ratio may be justified by "other relevant factors" according to ISS, without further outlining what such factors could be. Glass Lewis applies the 30 percent gender diversity rule to SMI and SMIM companies only. Glass Lewis advocates for a voluntary early adoption of the gender quota under Swiss law, ahead of the end of the transition period in 2026. Companies are required to provide an explanation in the compensation report in case they fall short of the minimum diversification and to describe measures to increase the representation of the underrepresented gender. Ethos sets a lower threshold of 20 percent unless applicable law provides for a higher ratio. Therefore, as long as the transition period for the Swiss gender quota have not expired, Swiss listed companies may comply with the 20 percent-rule from the perspective of Ethos.

Further, *Glass Lewis* introduced tighter rules for directors who qualify as overboarded: As potentially overboarded are deemed executive officers who serve on more than one board of a public company in addition to their executive office mandate. Potentially overboarded are also directors if they are a "full-time" or "executive" member of the board of directors and serve as board member on more than two additional boards of listed companies or for a board member (non-executive function) on more than five listed companies. A non-executive board chair position counts as two board seats for the purposes of the calculation of the number of board seats.

*ISS* introduced guidelines on unequal voting rights, which are not considered shareholder friendly in principle. These guidelines will apply from 1 February 2024 onwards, but hardly be relevant for Swiss listed companies given that the vast majority already comply with the "one share, one vote"-principle.

## 3 ESG AND ESG REPORTING

ESG reporting may be classified as a sub-category of governance. Because of the importance of ESG, we present the amendments and the potential implications for subject companies for the newly introduced ESG reporting obligations separately.

*ESG reporting*: While *Glass Lewis* presents a summary of the newly introduced Swiss rules on non-financial reporting, it refrains from giving any guidance on this topic. *Ethos* expanded its list of reasons for which it will recommend voting against the approval of a non-financial report. It will also issue a negative recommendation in case a company systematically fails to achieve its targets or in case the key ESG targets worsen over three years. Ethos expects reports on non-financial matters to be drawn up in accordance with a recognized standard (GRI, ESRS, ISSB or SASB) and reviewed by an independent third party. The report must cover all relevant topics of non-financial reporting for a company, whereby Ethos' guidelines provides for a target for each topic. Each topic must be defined in a way that it is measurable over a period of several years (at least three years).

*Say on climate*: *Ethos* expanded its list of negative recommendations for proposals on a "say on climate", which are, however, still rarely seen in practice: Ethos will issue a negative recommendation, among others, if (i) the company does not have specific reduction targets for its $CO_2$ emissions validated by an independent organization, which are compatible with limiting global warming to 1.5° and cover all direct and indirect emissions (scope 1 and 2 and at least 80 percent of scope 3[1]), (ii) the company neither details its measures to reduce $CO_2$ emissions nor how the measures contribute to its emission targets, (iii) Ethos does not deem the measures adequate or (iv) the Company does not publish its investment expenses, which are necessary to reach its $CO_2$ emission targets. Further, Ethos added more details about shareholder votes on climate reporting in its annex on corporate governance.

*ESG on incumbent directors*: Proxy advisors do not only analyze a company's ESG strategy and its implementation, but also look at how board members deal with these issues. *ISS* made some interesting amendments to its chapter about climate accountability for incumbent directors of significant greenhouse gas (GHG) emitters (only a very few Swiss companies qualify as GHG emitters). Namely, ISS removed the remark previously included in its guidelines that the expectations about "minimum steps to mitigate risks related to climate change will increase over time". This raises the question whether ISS is less ambitious in the upcoming years than it was for the past few years. While ISS does not provide any numerical GHG targets for minimum steps to mitigate climate risks, it requires, among others, "appropriate measures" for a recommendation. It describes "appropriate measures" as medium-term GHG reduction targets or Net Zero-by-2050 GHG reduction targets for company operations and electricity use. In any event, targets should cover the vast majority of the company's direct and indirect emission (scope 1 and 2). For scope 3 (i.e., indirect emissions in the supply chain), ISS does not provide any best practices and only states that

[1] Scope 1, 2 and 3 emissions categorize different kinds of direct and indirect carbon emissions of a company with scope 1 emissions covering direct emissions of a company, scope 2 emissions covering indirect emissions of a company and scope 3 emissions covering emissions that are created in its value chain (up and down) of a company.

the targets should cover the cast majority of the company's direct emissions.

While these changes are not groundbreaking, they start to have a higher importance for Swiss listed companies who are subject to the newly introduced Swiss non-financial reporting obligations and will have to submit their reports on non-financial matters must be submitted to the annual general meeting for the first time in 2024. Although companies are not subject to any shareholder vote on non-financial matters this year, they should by now have implemented a plan for the report to be published next year. To avoid negative surprises, companies should be aware of the recommendations of the proxy advisors when preparing their report.

## 4 AMENDMENT OF ARTICLES IN CONNECTION WITH THE CORPORATE LAW REFORM

*The* hot topic of this AGM season is the amendment of the articles of association to comply with the new rules amended by the Swiss corporate law reform which entered into force on 1 January 2023. Companies will have two years to implement the changes of the corporate law reform. We refrain from exploring the full range of challenges Swiss listed companies face in connection with the corporate law reform and focus on potential pitfalls, such companies may face when putting motions on an agenda to implement the Swiss corporate law reform.

The proxy advisors refrained from formulating best practices regarding the modalities for putting motions on the agenda to implement the Swiss corporate law reform. While this does not come as a surprise in case of the US based proxy advisors, *ISS* and *Glass Lewis*, it is somewhat surprising why Ethos did not provide any guidance. In our view, listed companies have several options how to present the motions regarding the amendment of the articles of association to implement the Swiss corporate law reform. Irrespective of the chosen option, listed companies should pay attention to the different majority requirements (e.g., the capital band requires a qualified majority) and might wish to have separate votes on certain topics which are sensitive, such as the introduction of the possibility of a virtual general meeting or the introduction of the capital band.

Some proxy advisors, namely *Glass Lewis* and *Ethos*, already considered the capital band (*Kapitalband*) in their guidelines, whereas ISS remains silent on the capital band. However, none of the guidelines address all questions a board of directors may face with the introduction of the capital band. Below, we highlight some of the key considerations:

- *ISS* does not refer to the capital band at all. As such, the general principles on capital increases and capital decreases apply. The general principles provide for a maximum of 10 percent of the existing share capital in case pre-emptive rights are excluded. It remains to be seen how ISS will apply this rule for the capital band and how it will look at increases and decreases within the capital band, in particular whether they apply different or additional restrictions given the possibility for a higher dilution if a board increases and decreases the capital several times during the lifetime of a capital band.

- *Glass Lewis* recognizes the capital band, including the possibility to increase and decrease the capital several times during the lifespan of the capital band and the potential higher dilution. In particular, Glass Lewis requires that the authorization does not exceed 20 percent of the issued share capital considering that the board may increase and decrease the share capital several times during the authorization of a capital band and applies this threshold across all authorities (excluding authorities reserved for specific purposes, e.g., equity incentive plans). Glass Lewis did not introduce a threshold for capital reduction within the capital band.

- *Ethos* provides a list of voting recommendations for the capital band stating, among others, a 10 percent threshold for capital increases with the exclusion of pre-emptive rights and 20 percent generally for capital increases. Capital reductions are limited to 5 percent of the issued share capital if the company does not provide "a sufficient justification". Ethos introduces further criteria, all of which remain vague: E.g., Ethos will recommend to vote against a capital band provision if it considers it inappropriate against the backdrop of the financial situation and perspective of a company.

All of the proxy advisors address hybrid/virtual general meetings and are skeptical about virtual meetings: *ISS* and *Glass Lewis* will consider in particular whether the company has committed to ensure that shareholders may participate in the shareholder meeting and believe that hybrid meetings (i.e., meetings which allow for both a physical and virtual participation) are preferable over virtual meetings. Also, ISS and *Ethos* will vote against an amendment of the articles of association if they allow for virtual meetings without a justified reason.

*Glass Lewis* added a recommendation for SMI and SMIM companies to disclose the votes in detail for a general meeting. Failure to do so results in a recommendation to vote against the election of the governance committee chair (or equivalent, such as the board chair or independent lead director).

## 5 COMPENSATION

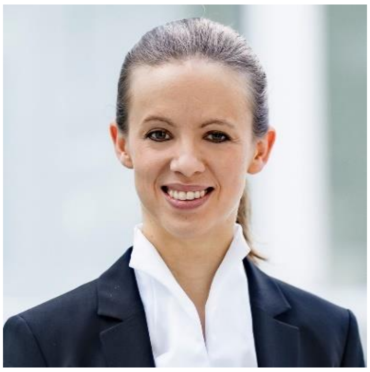
While *ISS* revised its section about compensation, the amendments do not include any surprises. The recommendations distinguish between remuneration for non-executive and executive directors with sub-categories for performance and non-performance-based pay. The guidelines now include recommendations about the remuneration report. As with other recommendations, ISS' recommendations remain vague and give ISS a large amount of discretion.

## 6 CONCLUSION

Although it can be said that none of the changes to proxy advisors' guidelines are groundbreaking, their implementation might prove challenging for companies in practice. In addition, the frequency of the changes requires companies to remain agile and adjust their governance on a regular basis if they wish to avoid negative recommendations by proxy advisors.

In line with investors' expectations, proxy advisors will have a close look at ESG reporting with the report on non-financial matters being subject to a mandatory shareholder vote for the first time in 2024. For this year, however, the focus of Swiss listed companies will lie on the corporate law reform.

## CONTACTS



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