Insights February 2021

Overview of the Main Trends for the General Meeting Season 2021

As the new annual general meeting season starts, we offer our insights into what Swiss listed s may expect from proxy advisors and institutional investors: ESG and diversity comes into the focus of proxy advisors and institutional investors. Proxy advisors continue to scrutinize compensation and demand higher disclosure.

Introduction

2020 was a quiet year for shareholders of Swiss listed companies. Due to Covid-19, most companies were forced to exclude the physical presence of shareholders, depriving shareholders of the possibility to voice critical opinions at the AGM. Proxy advisors were also less vocal as many companies were facing severe constraints during the Corona crisis.

Although the pandemic is not over and some companies are still struggling, we expect that proxy advisors will be stricter this year in applying their corporate governance principles and place more emphasis on sustainability.

This briefing summarizes some of the main changes proxy advisors announced for this proxy season as well as the focus of BlackRock (as an example of institutional investors) for 2021, followed by a brief outlook on the Swiss corporate law reform.

Proxy Advisors: Main Changes in ESG, in particular Diversity, and Compensation

ESG: Gender diversity in boards

Gender diversity in boards and executive committees is not a new topic, but has been debated already for years. However, in recent years, different players demanded a mandatory gender quota. While some European jurisdictions already enacted a mandatory gender quota years ago (in the case of Norway in 2008), the Swiss legislator wrapped the topic into the slow process of the corporate law reform, which finally came to bear fruit. The revised corporate law provides for gender quotas of 30% in boards of directors and 20% in executive management of larger Swiss listed companies. If a relevant company does not comply with the quota requirements, it must explain why it was not able to meet the relevant threshold(s) (*comply or explain*) and outline the measures it takes to promote the underrepresented gender. These rules on gender quota entered into force on 1 January 2021 subject to transitional periods of 5 years for the board rule and 10 years for the executive management rule.

While the Swiss legislator has chosen a remarkably slow path for the implementation of gender quotas, the most influential proxy advisors, ISS and Glass Lewis, have a more resolute agenda, which focuses on gender diversity at board level without addressing the executive management. Their guidelines require boards of Swiss listed companies to comprise, in principle, at least 30% in members of the underrepresented gender from 2022 onwards.[1] ISS allows companies not complying with this threshold to invoke mitigating factors, such as the publication of a firm commitment to comply within a year, provided that the company complied with the rule at the preceding annual general meeting, or "other relevant factors as applicable", which are not explained further. Glass Lewis also allows for exemptions for boards of four or fewer members in case the company discloses compelling reasons for its failure to meet the quota. Further, Glass Lewis will take into account the recent progress in board diversity.

While the rules of these proxy advisors are not applicable to this season yet, companies having less than 30% women on their board ought to begin their planning for new female board members already this year in order to be compliant in 2022. Although both proxy advisors provide for exemptions for certain cases, companies should be prepared to either comply with the rule or have a solid explanation for non-compliance as we expect proxy advisors to critically analyze the explanation for non-compliance.

ESG: Board eligibility

ISS refined, in its proxy guidelines for 2021, the definition of risk oversight as a criterion for a recommendation to vote for or against a board member. If a board member fails to demonstrate appropriate risk oversight of, among other things, environmental and social issues, such as climate change, ISS may recommend to vote against such board member. While we expect that such cases will be rare this year, board members should be aware that the management of environmental and social risks will move into the focus of proxy advisors.

Compensation disclosure

Compensation for members of the board of directors and executive management will be subject to strict scrutiny. Proxy advisors call for a higher disclosure standard of and a better explanation for compensation. ISS added the disclosure of (i) amounts paid to members of the executive management, (ii) the alignment between the performance by the company and the payout to the members of the executive boards, (iii) the disclosure of variable incentive targets and according levels of achievement and performance awards made after the relevant performance period (ex-post), and (iv) the disclosure and explanation of use of any discretionary authority or derogation clause by

[1] ISS: https://www.issgovernance.com/file/policy/active/emea/Europe-Voting-Guidelines.pdf; Glass Lewis: https://www.glasslewis.com/wp-content/uploads/2020/12/Switzerland-Voting-Guidelines-GL.pdf?hsCtaTracking=705763fc-e701-4825-b879-df7018b706cf%7C5529c4d2-5b99-434c-9b8e-f68ac75c5ed2. ISS applies the 30%-rule to widely-held companies, i.e., companies included in a major index and/or having a certain number of ISS clients holding their equity securities. Glass Lewis will apply the rule to boards of SMI and SMIM companies.

the board or remuneration committee to adjust pay outcomes. In connection with the calculation of a maximum variable compensation budget for a prospective binding vote, Glass Lewis expressed a preference that a long-term incentive should be accounted for in terms of the maximum payout opportunity rather than at-target value of grants of long-term awards. If a company opts for the latter, Glass Lewis expects a clear disclosure statement in the invitation to the annual general meeting. This demand is in line with a growing market trend which we have observed in recent years.

The details of how to follow this guidance remains vague and we will need to follow how strictly proxy advisors will apply these rules and what level of detail will be required. In particular, we expect to see practical challenges to comply with the recommendation of Glass Lewis regarding the calculation of long-term incentive instruments based on their maximum payout opportunity: while it may be straightforward to determine the amount when the long-term incentive plans foresee the application of multiples at vesting by applying the highest multiple for the purpose of disclosure of remuneration, it is, however, unclear, how Glass Lewis expects to apply this approach when the compensation tied to financial metrics or the development of the share price. In such cases, it is often not possible to make meaningful assumptions to compute the maximum payout opportunity.

For this proxy season, Swiss listed companies should also carefully consider the additional voting guidelines by ISS on the impacts of the Covid-19 pandemic which include, among other things, additional considerations on compensation. Under these guidelines, ISS will carefully assess any material changes in performance metrics, goals or targets used for compensation plans. Any repricing of options or awards will be assessed by ISS on a case-by-case basis.

BlackRock targets Sustainability

As one of the largest shareholders in many widely held Swiss listed companies, BlackRock plays a material role in the general meeting and Swiss companies should pay attention to its engagement policy. In his annual letter to the CEOs of companies in which BlackRock is invested, Larry Fink, BlackRock's chairman and chief executive officer, outlined BlackRock’s focus for the coming years. The letter stresses the importance of sustainability and names climate change as an investment risk. According to Larry Fink, companies have to be prepared for a significant reallocation of capital for a more sustainable world. The letter states that BlackRock currently undertakes a number of initiatives to make sustainability the focus of its investment approach.

BlackRock not only demands sustainability-related action from companies, but also a better reporting on sustainability. It recommends using the standards published by the Sustainability Accounting Standards Board (SASB) for sustainability reporting and the framework of the Task Force on Climate-related Financial Disclosures (TCFD) for climate related risks and related governance issues. It is worth to note that BlackRock does not refer to any other established sustainability reporting standards, such as the Global Reporting Initiative (GRI). Furthermore, the letter does not address other ESG topics, for example diversity. We find this surprising given the public debate and the demands from other investors, proxy advisors and other stakeholders.

BlackRock's CEO letter should be a wake-up call for companies that BlackRock will have a strong focus on sustainability and will take corresponding action if a company fails to meet BlackRock's demands on sustainability.

Outlook: Corporate Law Reform

The increased focus on ESG is an overarching trend and Swiss listed companies should view this as a long-term process which will allow them to meet the expectation of the different players rather than a one-off change. The Swiss corporate law reform will place increased requirements on disclosure of compliance with non-financial performance and, globally, we expect that institutional investors will place more scrutiny on such factors, as among other the European Union is rolling out the Sustainable Finance Disclosure Regulation.

It is, however, not the only development Swiss listed companies should bear in mind: The Swiss corporate law reform will introduce a variety of changes, including lowering thresholds to exercise minority rights such as calling a general meeting or putting a motion on an agenda, the possibility to hold shareholder meetings virtually or the so-called capital band authorizing the board to increase or reduce the share capital within certain limits. These changes will affect both the governance structure and provide more flexibility to listed companies.

While these changes do not yet have to be implemented at the upcoming AGM and proxy advisors remain largely silent on their expectation for an early implementation (except Glass Lewis who expects companies to implement the gender quotas early), companies would be well advised to prepare a roadmap for the implementation of the necessary changes and should also assess the desirability of such changes and the likelihood of their acceptance by shareholders and proxy advisors.

Conclusion

Boards of directors of Swiss listed companies are given a demanding agenda by the proxy advisors and the institutional investors for the upcoming years. These stakeholders' demands will force boards of directors to increasingly focus on corporate governance, in particular ESG and compensation matters. Although some of the changes will not apply by this AGM season, boards of directors are advised to take action now as some of the measures will take some time to implement.

Contacts

Prof. Dr. Rashid Bahar

Attorney at Law
T +41 58 510 92 91
rashid.bahar@advestra.ch

Daniel Raun

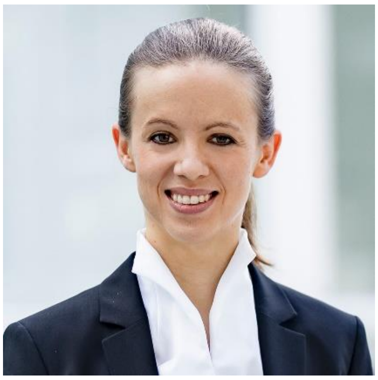
Attorney at Law
T +41 58 510 92 99
daniel.raun@advestra.ch

Dr. Thomas U. Reutter

Attorney at Law
T +41 58 510 92 80
thomas.reutter@advestra.ch

Roland Truffer

Attorney at Law
T +41 58 510 92 90
roland.truffer@advestra.ch



Annette Weber

Attorney at Law
T +41 58 510 92 29
annette.weber@advestra.ch

ADVESTRA

Uraniastrasse 9 | 8001 Zurich
T +41 58 510 92 00
www.advestra.ch | info@advestra.ch