

Swiss AGM Season 2018/2019: Shareholders and Proxy Advisors assess Board members more critically

Zurich, June 20, 2019 – For the first time, the most critical board elections received more votes against than the most critical compensation items. In the 10% most contested elections to the board of directors, the median proportion of against votes rose to over 20%. Shareholders voted against the election of the nominated board members mainly out of concerns about their independence, followed by doubts about the expected availability of the designated directors. Minority shareholders in companies with an anchor shareholder voted more negatively than shareholders in broadly held companies, especially in the most critical elections to the board, which are very important for minority shareholders. The increased focus of shareholders on board elections, which continue to be judged frequently on the basis of proxy advisor recommendations, increased the influence of proxy advisors, above all ISS. The diversity of the members of the board increased again: Boards became more international and more female. The proportion of newly elected women on boards of Swiss companies reached a new high. The votes on the remuneration report were less critical this season. This is largely due to improved disclosure and adjustments in the compensation systems by companies, rather than a diminishing attention on the part of investors. The latter keep the pressure high: if a company does not react to a compensation-related concern, the median of votes against compensation reports quickly rises to 30% and more.

These are some of the key findings of SWIPRA Services' analysis of the AGMs of the 100 largest listed Swiss companies between July 2018 and June 2019.

Next Events

Assurance and CSR

Roundtable for Auditors and Investors
September 18, 2019

2. Board Talk

Event for board members (by invitation)
TBD

SWIPRA Corporate Governance Survey

Presentation Key Findings
November 5, 2019

3. Swiss Corporate Governance Dialog

Event for issuers/investors
November 20, 2019

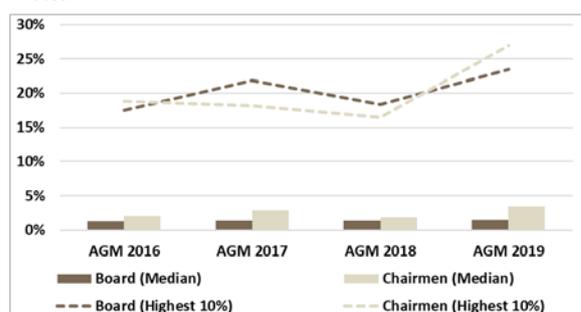
Board of Directors I:

More criticism and focus on independence

Despite an overall low proportion of against votes in elections to the board (median of 1.5%, previous year 1.4%) and of its chairpersons (3.4%, previous year 1.9%), board elections were, for the first time, the most critical AGM agenda items: of the 20 most critical agenda items, 50% concerned board elections and only 15% were remuneration-related items. With the increasing focus of shareholders on board elections (see SWIPRA AGM Season Outlook 2019), against votes rose distinctively.

Figure 1: AGM AGAINST votes in Board elections

Highest 10% refers to the median of AGAINST votes in the decile of board election items that received the highest level of AGAINST votes.





In the most critical 10% of board elections (see Figure 1), the median proportion of against votes rose to 23.4% (previous year 18.3%), in chairperson elections to 27.0% (previous year 16.5%) and in elections to the compensation committee to 26.3% (previous year 19.1%).

An analysis of the reasons disclosed by shareholders to vote against a proposed board candidate in critical elections (elections with more than 10% against votes) revealed that around 55% of the elections raised a flag due to independence concerns (regarding the individual candidate or the board/committee as a whole).

Yet, the issue of "independence" is complex and frequently leads to confusion, especially when the disclosure of companies on the independence of its board candidates is scarce, as it was criticized by a majority of institutional investors participating in the SWIPRA corporate governance survey 2018. Shareholders still analyze board independence oftentimes "mechanically", for example on the basis of the term of office of a board member. Similarly, proxy advisors, recommend voting against the re-election of board candidates with a tenure of less than 10 years in 8.1% (average) of the cases, but in 25.3% of the elections if the term of office has crossed 10 years.

Board of Directors II:

Critical minority shareholders, more diversity

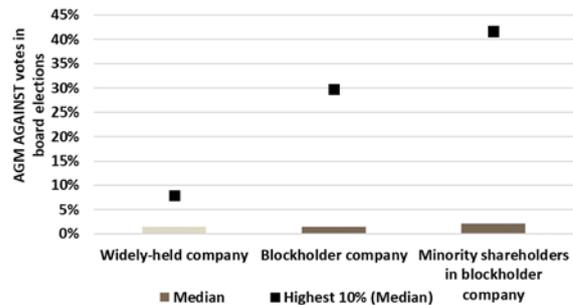
The board plays a particularly critical role in balancing different interests in companies with an anchor shareholder (shareholders with an equity stake of more than 10% in the company). In the most critical 10% of board elections in companies without an anchor shareholder (see Figure 2), the median against votes for board candidates was at 7.9%, whereas the fraction of against votes by minority shareholders in companies with an anchor shareholder was 41.7% (against votes at the AGM, corrected by the anchor shareholder's equity stake).

Shareholders' evaluation of the board also focuses on diversity according to various criteria such as director experience, background and professional

competence. These diversity criteria are recognized by governance research as well as shareholders as an important basis for a balanced and differentiated decision-making in the board.

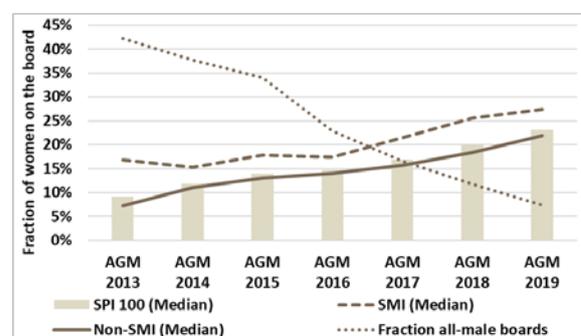
Figure 2: Board elections and minority shareholders

Highest 10% refers to the median level of AGAINST votes for the decile of items receiving the highest level of AGAINST votes. Blockholder refers to a company with an anchor shareholder controlling at least 10% of the votes.



The 2018/19 AGM season showed two interesting developments regarding personal diversity of board members: on the one hand, 55.2% of the newly elected members of the board were non-Swiss (48.1% in the previous year), suggesting an increasing internationalization of Swiss boards, and on the other hand, the proportion of women in new board elections reached an all-time high of 31.9% (23.4% in the previous year). Women now represent an average of 27.4% of the board seats of SMI companies (previous year 24.5%) and 22.0% of the board seats of non-SMI companies (previous year 18.5%). Since 2012, the proportion of women in the 100 largest listed companies has risen from an average of 9.1% to 23.1% (see Figure 3).

Figure 3: Fraction of female board members



Both the declining votes against the remuneration report and the development of diversity on the board can be interpreted as a positive outcome of companies' shareholder engagements, such



interactions clearly helping to address the increasing demands of investors regarding board members and decreasing the chance of being assessed on the basis of "tick-the-box" systems.

Proxy Advisors:

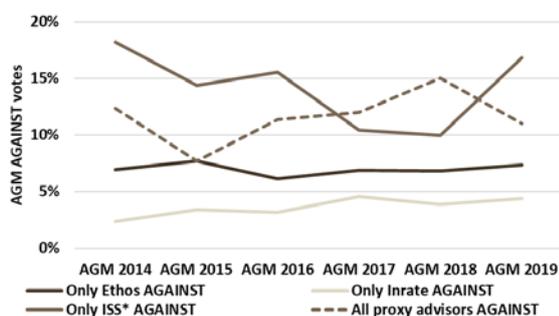
Increasing influence again, little common ground

The increasingly critical focus of large institutional shareholders on board elections and board composition also impacted ISS' voting guidelines, which were tightened eventually. Contrary to the often-heard argument, it is not so much ISS that influences the voting behavior of the large institutional shareholders, as it is the large institutional shareholders who influence the analysis framework of ISS.

Around 80% of against recommendations issued by ISS only were related to board election items. As mentioned above, institutional investors and proxy advisors base their analyses, especially for board elections, on various "tick-the-box" criteria. More than half of the board elections for which only ISS recommended an against vote were in office for more than 10 years or older than 70 years. Companies can only counter such rigid criteria, if at all, through a direct dialogue with their major institutional shareholders. Recommendations to vote against an agenda item by ISS only were mostly issued for non-SMI companies with a major shareholder. These companies generally engage less in an active dialogue on corporate governance with shareholders and, therefore, institutional shareholders generally rely on the proxy advisor

Figure 4: Unique proxy advisors' AGAINST recommendations and actual AGM voting outcomes

ISS recommendations are not publicly available and are approximated by voting reports of market participants relying on ISS proxy voting guidelines.



recommendations (see SWIPRA Corporate Governance Survey 2018).

As a consequence, proxy advisors, especially ISS, were again able to increase their influence on shareholder votes in this year's AGM season (see Figure 4). In the case of agenda items that were exclusively recommended for rejection by ISS, the median fraction of AGM AGAINST votes was 16.8% (previous year: only 8.1%).

The evaluation of the 2019 AGM season also shows that there are major differences in philosophy between proxy advisors. In the period under review, there were only 11 agenda items recommended for rejection by all proxy advisors, corresponding to an "overlap" in AGAINST recommendations of just 0.7%. When analyzing remuneration reports, the opinions of the two major international proxy advisors, ISS and Glass Lewis, seem to diverge particularly. Their against recommendations correspond in only 17.6% of the cases, significantly less than for example those of Ethos and ISS (26.7%) or Inrate and ISS (32.4%).

For investors, this low level of "overlap" between the proxy advisors shows that it can be problematic to rely exclusively on the opinion of a single proxy advisor without scrutinizing the recommendations carefully and carrying out one's own analysis. At the same time, the low level of overlap makes it more difficult for companies to assess the voting behavior of their shareholders.

Compensation reports:

Less criticism, still high pressure

Another interesting development concerns remuneration. The median level of against votes on the remuneration report fell from 12.8% in the previous year to 9.9%, the lowest level since the introduction of the Ordinance against Excessive Compensation. This is likely a result of changes implemented by companies in their remuneration systems, the better disclosure quality in company reports and their willingness to respond to shareholder concerns. In the current AGM season, around two out of three companies that received against votes in excess of 20% on their



remuneration report in the previous AGM were able to reduce the proportion of critical votes to the market level of approximately 10%. Three years ago, it was only one out of three companies. For many companies, the pressure to respond to shareholder concerns remains high. For example, a company not reacting in case of 20% or more against votes on last year's remuneration report, must expect a level of against votes on the remuneration report of up to 82% (33% at the median) at next year's AGM.

In context of a company's disclosure and the public perception of performance-related compensation, "pay for performance" plays an important role. The fact that shareholders attach great importance to this concept is reflected in the voting outcomes for the remuneration reports of the last three years. If total shareholder return of the company lags behind that of its peer companies (rTSR), but at the same time the bonus of the CEO increases, 14.7% (median) of shareholders voted against the remuneration report (in the most critical quarter of companies, against vote were more than 22.3%). If both, the rTSR and the bonus increased, the median share of votes against was only 10.9%, i.e. 25.9% lower (for the most critical companies against votes were more than 16.0%, lower by 28.3%).

The less critical votes on the remuneration report should not be interpreted a priori as a sign of diminishing investor attention. Rather, this observation must be understood as the positive result of the companies' reactions to criticism from their shareholders.

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About SWIPRA Services

SWIPRA analyzed the results of AGM's held by the 100 largest Swiss listed companies (SPI100) during the period between July 1, 2018 and June 10, 2019. Data on ISS recommendations is not publicly available and approximated by market observations. The overall analysis contains more data than described in here. For further information please contact SWIPRA. www.swipra.ch

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