

2014 Annual General Meeting season:

Voting trends emerge as Swiss companies start implementing new executive pay rules

Executive Summary

Over the 2014 Annual General Meeting (AGM) season many listed Swiss companies have made significant progress with implementing the provisions of the Ordinance Against Excessive Compensation in Listed Companies (Ordinance). Shareholders have voted on various Ordinance related resolutions, including amendments to the Articles of Association (AoA) and, in some cases, the compensation amounts of the board of directors and executive committee. In addition, companies continued to hold consultative votes on their compensation report.

A number of trends have emerged in terms of both implementation of the Ordinance and shareholder reactions to approaches adopted. Insight into these trends have assisted effected companies to determine actions to be taken over the coming year.

Background

The final Ordinance, which came into effect on 1 January 2014, contains various provisions which take effect over the period until the end of 2015. Some of the key provisions, and their final dates for implementation are:

- ▶ Prohibition on severance payments, payments in advance and transaction commissions from 1 January 2014
- ▶ Annual election of board members, chairperson and compensation committee members from 2014 AGM
- ▶ Annual binding vote on the compensation of executives and board members from 2015 AGM
- ▶ Board preparation of the 2014 financial year compensation report, which must be audited
- ▶ Amendment of AoA by 2015 AGM (for example, voting approach, compensation principles, any budget for new appointments)



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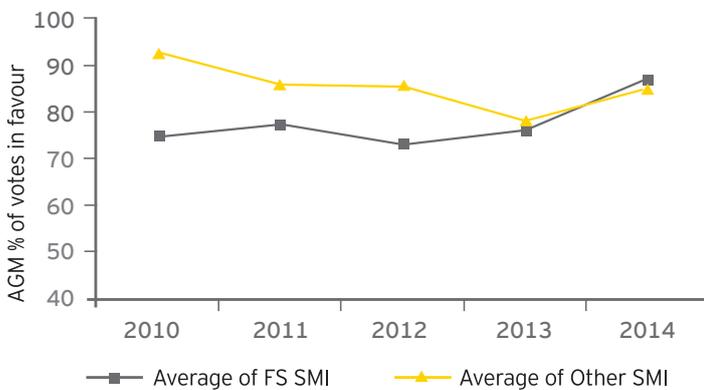


Voting results at 2014 AGMs

Almost all SMI companies held consultative votes on their compensation report at their 2014 AGM, as was the case in earlier years. The average approval rate for SMI companies in 2014 was 86%, representing an increase of 10% compared to 2013.

Historically, Financial Services (FS) companies voting results were lower than non-FS companies. Since 2013 the voting results have aligned.

Average FS SMI voting results compared to average non-FS SMI voting results



A small number of companies (seven SMI companies) held a vote on the total compensation amount in alignment with the Ordinance (in two cases advisory voting only), with the following findings:

- ▶ All companies received votes in excess of 90% approval, with the exception of four that ranged between 61% and 87%
- ▶ Median approval rate was 94% for the total compensation of the board of directors and 92% for the executive committee

Among the companies that amended their AoAs at the 2014 AGM, 40% indicate that an additional consultative vote on the compensation report will be maintained. It appears that such an approach may emerge as best practice, particularly for companies that have adopted prospective voting on compensation amounts. A consultative vote on the compensation report provides shareholders with the opportunity to verify approval the amounts paid as well as indicate the level of support for the company's compensation policy. The approach is also in line with many key international markets, such as the United Kingdom and the United States.

Ordinance implementation approaches

Most SMI companies opted for early implementation of the Ordinance provisions to be included in the AoAs. Fifteen SMI companies held a vote to amend their AoA for full alignment with the Ordinance at their 2014 AGM.

- ▶ Most companies held a single vote for this purpose, with one quarter opting for 2 to 3 votes (such as separate votes on compensation and corporate governance matters)
- ▶ The average approval rate for SMI companies' votes to amend their AoA was 88% (to date only two Swiss companies, both outside the SMI index, have had their AoA amendments rejected)

Some of the key trends in relation to the approaches taken by companies when amending their AoA are outlined below.

Compensation voting approach

Most (87%) of the fifteen companies that changed their AoAs for the binding voting on compensation amounts proposed a compensation period from AGM to AGM for their Board.

The most common (53%) proposed compensation period for executives was prospective on all compensation for the next financial year. All other companies adopted combinations of retrospective and prospective compensation periods, typically split between variable and fixed pay respectively.

Compensation vote approach - Executives



Compensation principles

More than half of the SMI companies proposed compensation principles that have a medium level of tailoring for shareholder approval. Indicators of the level of tailoring include:

- ▶ Variable compensation caps: Around one third of companies refer to specific variable compensation caps. Companies have different approaches to setting caps so that, for example, they could be referable to a proportion of base salary and/or target achievement
- ▶ Vesting / blocking (LTI): Almost half of the SMI require a minimum vesting / blocking period for long-term incentives, the majority of which state 3 years

In many cases shareholders and proxy advisors remain highly critical of such aspects of executive compensation programs. Other areas of contention include approaches to the valuation of equity, provision of loans, acceleration of vesting and inclusion of non-compete payments.

Next steps and recommendations

While companies have begun to implement the Ordinance provisions, there remain areas of particular strategic importance that continue to receive attention including:

- ▶ Reviewing the compensation system to ensure a sufficient level of pay for performance and long term orientation
- ▶ Focusing on engagement with shareholder advisory bodies to mitigate the risk of shareholder disapproval on compensation votes
- ▶ Preparing a new compensation report to be audited and ensuring that the compensation report is aligned with the compensation vote approach. For example, ensuring valuation methodologies and terminology is consistent with the compensation vote approach and using communication strategies in support of shareholder approval
- ▶ Companies may wish to consider whether to continue (or implement) advisory voting on the compensation report particularly if prospective voting is adopted
- ▶ Companies that have not yet amended their AoAs will need to prepare and submit them for approval at the 2015 AGM, a process which may be supported by referring to market trends

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