

MARKET EXPERT INTERVIEW VINCENT KAUFMANN

CEO OF ETHOS FOUNDATION AND ETHOS SERVICES



What advice would you give a Swiss listed company trying to secure and/or maximise shareholder support for its annual general meeting? What different processes should be put in place and when?

It is key for the issuers to be proactive and to get in touch with investors well in advance, preferably whilst preparing the agenda for the next AGM and the next annual report. In my opinion September/October is the key period to get feedback on the previous AGM from shareholders and proxy advisors. Larger companies are increasingly doing this but mid or small cap companies seem to be more reactive. These smaller companies need to consider international governance practices and by doing this they could anticipate potential issues given that most of their investors are international. The three key messages are anticipation, engagement with key investors, and getting feedback early. The Chair of the various committees which makes up the board needs to be involved in anticipating potential issues that investors will have. Nowadays, committees play a key role in preparing and anticipating investors' expectations. Particularly regarding the board's succession plan, remuneration and increasingly, environmental and social issues. The processes put in place by issuers should be centred around discussions with a broad shareholder base and gaining an understanding on international best practices regarding governance. The Swiss code of best practice for corporate governance dates back to 2000 and is now outdated so needs a review. For example, on the question of what makes an independent board member, the only requirement of the code in Switzerland is that they are not a former executive of the company, which is not sufficient.

ESG has come under increased scrutiny in 2022 with high profile accusations of green-washing and criticisms of uncorrelated extra-financial agency ratings for instance. Do you believe private sector (on the one hand) and regulatory (on the other hand) initiatives are moving in the right direction on this topic and what in your view are the biggest hurdles/challenges to overcome?

We have to move to ESG 2.0. ESG integration should now just be a normal part of the investment process. It's not just about being sustainable, but also being a good asset manager; considering all indicators of an issuer's success. The impression of greenwashing comes from investors only integrating sustainability related risks (to the issuer), but ESG and the impact of the company on the wider environment and society are two sides of the same coin. Investors must move on to consider double materiality – what is the

impact of the company on society? If you integrate that side, some highly rated companies would certainly have a lower ESG rating. There is a large expectation gap between what the investors claim and what society and our client pension funds expect. A real step forward would be the standardisation of ESG reporting with the rigour that goes into reporting financial statements also applying to ESG reporting. However, I don't think we can standardise opinion on the sustainability rating of an issuer. The opinions of what is important varies between different ratings agencies. For example, Tesla may have a negative ESG rating for an investor who has a strong weighting on governance but when also considering their product the ratings may be better. The private sector can produce a consistent standard of ESG reporting, however only the regulator can make sure it is followed by bringing in rules to enforce it, like listing requirements. The regulator pushing investors to report is a positive step, but in order to report, you need good, consistent information and disclosures. The EU is right to impose CSDR on issuers and SFDR on investors, but Regulators need to be careful that the phrase "don't put the cart before the horses" doesn't apply to them. The impetus needs to come from the investors and issuers.

Your public comments on UBS' management proposed climate roadmap clearly demonstrate you felt they didn't go far enough or that the scheme was not sufficiently comprehensive. Where does that stand against shareholder led climate resolutions and where did they go wrong that another issuer might succeed in garnering your support on say on climate?

First of all, we commended the step made by UBS to voluntarily submit their Climate Strategy to a consultative vote of the shareholders. I am sure that this step prevented further pressure from shareholders like we saw at the AGM of Credit Suisse, where a climate resolution on their financing of fossil assets was submitted by Ethos and other investors. UBS also has exposure to fossil assets but on a smaller scale in comparison to Credit Suisse, and they proactively requested feedback from investors. Banks are normally less reactive so it was good to have this constant discussion.

This approach from UBS saw off a more proactive intervention by activists, but the pathway to net zero for UBS remains unclear. Ethos have been really pushing in this area, setting out requirements on how to vote on say on climate resolutions. For us, UBS' financing policy on coal is currently lagging behind the market, and on oil and gas they should be more restrictive regarding non-conventional oil and gas.

“In terms of ethnic diversity, Switzerland is very poor”

It should be an easy fix for them because they have comparably little exposure in this area. With regards to asset management, we felt they had a good target on sustainable investment strategies but such strategies represent 25% of their total assets under management. Their standard portfolios could have better coverage on CO₂ targets. Some of our clients believed Ethos were being too tough, but aiming for net zero isn't enough, we need clear and concrete targets accompanied by precise measures to reach them. We have published clear criteria on say on climate resolutions in the past years and will adhere to this policy. If you simply vote 'for' the item, the discussion ends.

With Credit Suisse there has definitely been a more robust approach from our side. We have been in discussion with them for many years. Their new policy on coal financing, published in November 2021, was a step forward whereby no new client would be accepted with more than 5% exposure to the coal industry (on the financing side). The bank however refused to further strengthen its financing policy. Given its high exposure to fossil assets, we decided together with ShareAction, who is running similar engagement in the UK, to increase pressure with a shareholder resolution. In Switzerland, the only way to submit a resolution is to request an amendment to the articles of association. We therefore asked the company to put in its articles of association an obligation to disclose how it intends to reduce its fossil assets exposure. Credit Suisse offered a climate report, but when there are three different heads of sustainability in one year, such an agreement with one is not enough. We weren't asking for change on day one, or day two, but we needed to see tangible movement in the right direction. Between the submission of our resolution and the publication of the agenda, we had a lot of discussion with the bank which agreed to include further restrictions on Arctic drilling and oil sands. Credit Suisse will be submitting its next climate report to an advisory vote in 2023 but we felt this approach was insufficient and maintained our shareholder resolution which received 19.35% support – a good result, especially when you consider we didn't have the support of ISS, Glass Lewis, BlackRock or the Qatari shareholders. It shows what the majority of the minority shareholders are thinking, and that we are willing to escalate. We are still involved in discussions, however the need for proactivity (from the issuer) is still there.

On diversity on Boards, we note that your guidelines stipulate that re-election of the chairman of the nomination committee cannot be approved if the board includes less than 20% women without satisfactory explanation. As the market moves towards greater female representation on Boards following the entry in to force on 1 January 2021 of the gender quota for boards from the Swiss code of obligations, how are you finding issuers respond to this challenge in a market which has historically been low in female representation?

In essence, not too bad! Pressure from international investors means large cap companies are already aiming for 30% female representation on Boards by 2026. Furthermore, they also have ten years from 2021 to achieve 20% female representation in management. Also, this is on a comply or explain basis, which we think it is a good thing. As an advisory agency, we believe our stance on opposing the nomination committee chair is pushing the market in the right direction. We opposed around 38 board members this year in companies where diversity was insufficient. We also made exceptions when we received written confirmation from the Board that diversity will be reinforced by the next AGM. For example, one issuer had one female director standing down and three new directors being appointed. They explained that they were looking for industry specific experience at this stage of their development and couldn't find a suitable female candidate. They acknowledged appointing a female director was at the forefront of their succession planning, and that there would be two outgoing directors in the next year with easier to replace competencies like legal and accounting experience. Their stated priority in the next year will be to seek a female replacement. This information can be from a roadshow but really gives the issuer the ability to gauge the views of the investors. The key for issuers is being proactive, feeling pressure from investors and being forward looking.

Mid and small cap Swiss boards, often with major shareholders or older boards are traditionally in favour of board discretion and make no commitment, or make statements like 'we will respect the quota in due time', or 'we cannot remove this person/expand the board'. This is not a commitment and is not convincing for us. What we want to see is how issuers are moving in the right direction and where we see a proactive board we are willing to make an exception and recommend a vote in favour. As with all the topics we have discussed, direction of travel is needed. In terms of ethnic diversity, Switzerland is not at the forefront. Surely an international company has to represent international best practice, with Switzerland lagging behind countries like France and the UK. Going back to the first question on advice for Swiss issuers, it is important that international practices are followed to reflect the ownership being international.

What additional trends, if any, have you observed in the Swiss annual general meeting season this year and what do you expect for 2023?

ESG and compensation are definitely high on the list where we expect issuers to set challenging environmental targets, but we are not proscriptive on this. If ESG targets are introduced as performance criteria such criteria has to be reported, measurable, verified and challenging. Some companies introduce ESG criteria without properly reporting on them which is not satisfactory. If it's part of variable pay, we need to be as critical in assessing ESG criteria as we would be for financial measures, and the targets must be equally stretching. Otherwise, we prefer no ESG criteria. Some Swiss issuers like Givaudan, Abb, or Holcim have introduced CO₂ reduction targets in their LTIP. We can now assess how challenging the targets are. If payout starts for a small CO₂ reduction which is not compatible with a 1.5° pathway, we consider that we are in a "pay for failure" mode. It's the same discussion on TSR awards below median. ESG targets are a good trend, but they need to be positive.

Do you have any comments on the strengths/weaknesses of Swiss corporate governance practices vs the rest of Europe? What do Swiss issuers do better or worse?

We've talked about some of the negatives but overall there are some significant positives like the ordinance against excessive compensation. We have almost caught up with France on the number of agenda items. From 2024 there will be a mandatory sustainability report which will have to be submitted to shareholder approval. Swiss companies are progressing quickly. This is a good thing as the current code of best practice in corporate governance is rather poor compared to international best practice. Mid and small cap companies, often family owned, seem to fly under the radar and sometimes use the Swiss code as a defence saying they respect best practice. If they want to enlarge their investor base with international investors, these companies need to communicate better and look at international best practices.

Vincent Kaufmann has been the CEO of Ethos Foundation and of Ethos Services since June 2015. Vincent Kaufmann joined Ethos in 2004 as a Corporate Governance Analyst, later becoming a Senior and Deputy Head Corporate Governance. He has been member of Ethos Services' management in charge of investment since 2011 and deputy CEO since 2013. Since 2014, he has been a member of the board of directors of the proxy voting consultant Proxinvest (Paris) and, since June 2019, of the board of Swiss Sustainable Finance. Vincent Kaufmann, a Swiss certified Expert for Accounting and Controlling since 2009, holds a Master's degree in Business Economics of the University of Geneva (2004).

