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Issuers should seek more engagement with investors, explain better how they generate value, and work with investors on a Swiss code of accountable governance.

Swiss issuers must actively engage with increasingly influential international investors. Issuers and investors should work together on a commonly supported Swiss code of accountable corporate governance. Policy makers are urged to avoid legislating 'best practices'. Recent fashions in executive compensation, such as the use of performance shares, should be carefully examined. Reporting on both financial and non-financial value drivers needs to improve. All these points are revealed in the most recent SFI White Paper.

Zurich, 7 December 2016. Effective corporate governance requires an integrated view of the 'governance cycle', comprising shareholder participation, board composition, managerial compensation, and value reporting. In the most recent SFI White Paper, *Corporate Governance: Beyond Best Practice*, Professor Alexander Wagner (Swiss Finance Institute & University of Zurich), and Dr. Christoph Wenk Bernasconi (University of Zurich) provide such a framework. Building on an analysis of the state of Swiss corporate governance, they outline possible future developments and propose ideas regarding action points for the next Annual General Meeting (AGM) season and for the ongoing revision of the Swiss Code of Obligations.

- Move from 'comply-or-explain' to 'decide-and-explain'. Corporate governance design only supports value generation if it fits a company's specific situation. A rules-based (tick-the-box, 'best practice') approach, often used in regulation and some proxy advice, does not do justice to the complex realities that firms face. Indeed, rules-based and principles-based (situational) analyses of corporate governance issues generally result in different conclusions. An example is a gender quota for board members and executive management, which is currently under discussion in the context of the ongoing revision of Swiss company law. A board of directors generates value not by simply complying with a fixed rule, but by searching for the candidates with the most valuable and complementary skills and experience. The popular 'comply-OR-explain' approach to regulation only seems to offer flexibility. In fact, the 'comply' rule as the default generally limits companies' own thinking and choices. "Instead, it often would make more sense for companies to first consider what's best for them and their stakeholders. Thus, companies should 'decide AND explain'", says Alexander Wagner.
- Seek engagement. Voting participation at Swiss AGMs has increased substantially over the years, from 55% in 2012 to 70% in 2016. Survey results show that investors are increasingly unwilling to just 'trust the board of directors'. The already fast-increasing numbers of passive investors, who will only grow in importance, lead the way: they are passive in terms of trading, but the most active of all investors in terms of corporate governance engagement. Many of these investors are based in the US or the UK. Swiss issuers need to engage with these investors effectively to ensure that their voting reflects local factors and goes beyond more general 'best practice'. "Mutual understanding between issuers and

investors could be facilitated via a Swiss code of accountable corporate governance, a stewardship code supported by issuers and investors alike," remarks Christoph Wenk Bernasconi.

- **Manage compensation risks.** Besides summarizing compensation levels in the top 100 companies, the SFI White Paper also critically reflects on compensation structure. Many companies have replaced stock options with performance shares (shares whose vesting depends on the attainment of certain performance conditions) in the hope of reducing risk-taking. This hope, though, is a fallacy with possibly severe consequences. With these 'best practice' compensation instruments, strong risk incentives remain in place but may be forgotten instead of being managed properly. As an alternative, simple share grants for long-term compensation elements would be appropriate in many circumstances. Another issue is that value creation requires obtaining a return on invested capital above the cost of capital. Thus, future compensation design should consider a company's cost of capital as an integral part of internal success management, together with a transparent disclosure of the related incentives.
- **Report on financial and non-financial value drivers**. A review of 228 annual reports of Swiss companies according to a scorecard shows that issuers have opportunities to improve in the next AGM season: Only 32% of the 2016 reports fulfill modern standards of value reporting and a mere 14%of companies reported sufficiently on non-financial factors. This matches with survey evidence. For example, only 19%of asset managers surveyed think the available information about knowledge diversity on the board is sufficient. Moreover, while 85.7% of the issuers surveyed believe they disclosed all the relevant information on compensation, only 44.6%of the investors agree. In fact, the fraction of investors satisfied with pay-for-performance disclosure sank to only 21.4% in 2016. Improving value reporting should be in the interest of companies, as empirical evidence suggests that it can help lower the cost of capital and improve internal decision-making.

The SFI White Paper is available at www.sfi.ch/wpcorporategovernance.

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