



# 2023 PROXY VOTING GUIDELINES

## CORPORATE GOVERNANCE PRINCIPLES

22<sup>nd</sup> edition



The **Ethos Foundation** brings together over 220 Swiss tax-exempt pension funds and institutions. Created in 1997, its aim is to promote socially responsible investment and to foster a stable and prosperous socio-economic environment.

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**Ethos Services** provides advisory services in the field of socially responsible investments. Ethos Services offers socially responsible investment funds, analyses of shareholders' meetings with voting recommendations, a dialogue programme with companies as well as environmental, social and governance ratings and analyses of companies. Ethos Services is owned by the Ethos Foundation and several members of the Foundation.

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# INTRODUCTION



# 1. Preamble

Institutional investors are entrusted with managing assets on behalf of a large number of beneficiaries. It is therefore their fiduciary duty to protect and enhance the long-term interests of the end-owners they represent. Ethos considers active share ownership as a means of obtaining higher long-term returns and contributing to the efficient functioning of the financial markets. Voting at shareholder meetings and engaging in sustained dialogue with companies are two basic elements of active ownership. This document sets out Ethos' proxy voting guidelines and corporate governance principles. These are the references that under-pin both Ethos' dialogue with investee companies and the vote at share-owners' general meetings.

Ethos considers that best practice in corporate governance is indispensable for the implementation of a strategy based on corporate social responsibility, as well as to ensure adequate mechanisms of control. Ethos' voting guidelines and corporate governance principles are based first and foremost on the main codes of best practice in corporate governance. Adherence to corporate governance best practice is a fundamental principle of corporate social responsibility and is necessary to ensure adequate control mechanisms and limit risk for investors. The voting guidelines and corporate governance principles are also based on Ethos' Charter, which is grounded in the concept of sustainable development where corporate decisions are shaped not only by financial, but also by social, environmental and corporate governance considerations. In this respect, Ethos is convinced that loyalty in the relations

between a company and its various stakeholders contributes substantially to the company's long-term sustainability and its future value. For this reason, Ethos' approach is resolutely inspired by a long-term vision of a company.

Ethos' proxy voting guidelines and corporate governance principles serve a dual purpose. First, they set out the position on essential issues of corporate governance of an institutional investor committed to sustainable development and responsible investment. Secondly, they allow a systematic and consistent exercise of shareowner voting rights aiming at promoting the long-term interests of a company's shareowners and other stakeholders.

The proxy voting guidelines provide detailed explanations of Ethos' voting recommendations on the different issues submitted to the vote at general meetings. These recommendations are constructive in spirit since a shareowner should be able to trust the board of directors and ratify its proposals. Nevertheless, where careful scrutiny leads to the conclusion that the board's proposals are not in line with the long-term interests of the shareowners and other stakeholders, an abstain or oppose vote might be appropriate.

Ethos' analysis is based on the "sub-stance over form" principle. Thus, when proposals put to the vote are contrary to Ethos' spirit, as laid down in its Charter, Ethos will oppose them despite an apparent adherence to form. In light of the diversity and complexity of some situations, Ethos reserves the right, should the need arise, to adopt a position not explicitly foreseen in its guidelines. In such



cases, a clear and documented explanation of the rationale underlying its position is provided.

This document is divided into ten sections covering the main issues in the field of corporate governance. The principles establish high standards regarding the attitude expected from companies toward their share-holders and other stakeholders. The voting guidelines take into account the current state of corporate governance in Switzerland and abroad. Given that corporate governance standards, the legal and regulatory framework, as well as awareness of environmental and social challenges vary considerably from country to country, Ethos can be led to adapt its voting positions to the particularities and realities of each market.

The voting guidelines and principles of corporate governance are revised annually.

## 2023 edition

The 2023 edition has been reviewed and adapted to the ongoing developments in legislation and best practice.

For the 2023 edition, Ethos has updated its guidelines to consider recent developments in the field of votes on corporate sustainability reports (from the 2024 general meetings for Swiss companies) and on companies' climate transition plans ("Say on Climate" vote).

This 2023 edition also reinforces Ethos' expectations towards companies and their boards of directors to take sustainability into account in strategic decisions, the review of risks and opportunities as well as in decisions related to the composition of the board or the remuneration policy.

As for Switzerland, the current edition takes namely into account:

- The Swiss Code of Best Practice for Corporate Governance of *economiesuisse* (February 2016).
- The Corporate Governance Directive (CGD) of the Swiss stock exchange SIX Exchange (December 2016).
- The Swiss code of obligations (CO) valid as of the 1 January 2023 that includes the implementation of the ordinance against excessive remuneration (ORAb)





# 2023 PROXY VOTING GUIDELINES



# 1. Annual report, accounts, Dividend and Discharge

Situations that do not fall under a specific recommendation are to be assessed in light of Ethos' Principles of corporate governance.

## 1.1 ANNUAL REPORT AND ACCOUNTS

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The information presented to the shareholders does not meet corporate governance or sustainability reporting best practice standards.
- b. Serious doubts are raised concerning the quality, sincerity and comprehensiveness of the information provided.
- c. The annual report or the financial statements were not made available sufficiently in advance of the general meeting.
- d. The board of directors refuses to disclose important information, or responds to legitimate requests for supplementary information in an unsatisfactory manner.
- e. There are serious and demonstrable failings in the statement of accounts.

## 1.2 DISCHARGE OF THE BOARD OF DIRECTORS

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The external auditors' report expresses reservations concerning the board's conduct of the company, or reveals serious shortcomings in the exercise of board members' duties or deficiencies of the internal control system.
- b. The board of directors refuses to place a validly tabled shareholder resolution on the agenda or refuses to implement a shareholder resolution that received a majority of votes at previous general meetings
- c. The company, the board of directors or any of its members are the subject of legal proceedings or convictions in connection with company business.
- d. There is profound disagreement concerning the management of the company's affairs or the decisions of the board of directors or some of its members.
- e. Serious shortcomings in corporate governance constitute a major risk for the company and its shareholders.



- f. The size of the board of directors has persistently remained below 4 members.
- g. There is a strong deterioration of the company's financial situation due to successive poor financial results, large impairments or significant new provisions for litigation costs.
- h. The company is in a situation of capital loss, of over indebtedness, in a definitive moratorium, or there is a material uncertainty on the ability of the company to continue as a going concern.
- i. The board of directors has made decisions that constitute a major environmental or social risk or it does not recognise the major environmental/social issues that the company faces.
- j. The company is involved in an accident that seriously harmed the employees' health, local communities or the natural environment.
- k. There are well grounded accusations against the company for serious violations of internationally recognised human rights of employees, local communities, or the company is complicit in such violations along the supply chain.
- l. The company refuses to recognise the negative impact of some of its products or its operations on humans or the natural environment.

### 1.3 ALLOCATION OF INCOME AND DIVIDEND DISTRIBUTION

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The proposed allocation of income seems inappropriate, given the financial situation and the long-term interests of the company, its shareholders and its other stakeholders.
- b. The proposal replaces the cash dividend with a share repurchase programme.
- c. The dividend is replaced by a reimbursement of nominal value of the shares that substantially deteriorates the shareholders' right to place an item on the agenda of the annual general meeting.



## 2. Sustainability

### 2.1 SUSTAINABILITY REPORT

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The report has not been established according to a recognised standard in terms of extra-financial reporting (GRI or SASB).
- b. The report and/or relevant indicators were not verified by an independent third party.
- c. The report does not cover all material topics with quantitative indicators.
- d. The report does not include targets for material topics.
- e. The company does not consistently meet its targets or there is a deterioration in key indicators on material issues over a 3-year period.
- f. There are significant doubts on the quality, veracity and completeness of the information provided.
- g. The sustainability report was not made available sufficiently in advance of the general meeting.
- h. The board of directors refuses to disclose important information or responds to legitimate requests for supplementary information in an unsatisfactory manner.
- i. The company is subject to serious controversies which are not addressed in the sustainability report.

### 2.2 CLIMATE STRATEGY (SAY ON CLIMATE)

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The company has not set targets for reducing its CO<sub>2</sub>e emissions which are compatible with a maximum of 1.5° warming, which cover all its direct and indirect emissions (scope 1, 2, and at least 80% of scope 3) and verified or being verified by a recognised body.
- b. The company does not publish intermediary reduction targets.
- c. The company does not detail the measures to be taken in order to reduce its CO<sub>2</sub>e emissions or their contribution to the achievement of its objectives.
- d. The measures taken by the company to reduce its CO<sub>2</sub>e emissions are considered inadequate.
- e. The company does not disclose the capital expenditure required (Capex) to achieve its CO<sub>2</sub>e reduction targets.



- f. The company does not commit to publishing an annual report on the implementation of its strategy.

## 2.3 CLIMATE REPORT (SAY ON CLIMATE)

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The company's report has not been drawn up in accordance with a recognised standard covering the main issues of climate change (governance, strategy, risks, indicators, and targets).
- b. The company does not publish its CO<sub>2</sub>e emissions in accordance with the GHG Protocol or its report does not cover at least 90% of indirect emissions linked to the life cycle of products (supply chain, transport, travel, use of products corresponding to scope 3 of the GHG Protocol).
- c. The company has not set targets for reducing its CO<sub>2</sub> emissions which are compatible with a maximum of 1.5° warming, and which cover all its direct and indirect emissions (scope 1, 2, and at least 80% of scope 3).
- d. The company does not publish intermediary reduction targets.
- e. The company does not communicate on the progress that were made with regard to its climate targets.
- f. The company is not taking adequate measures to reduce its CO<sub>2</sub>e emissions.
- g. The company does not consistently meet its targets or there is a deterioration in key indicators over a 3-year period



## 3. Board of directors

Situations that do not fall under a specific recommendation are to be assessed in light of Ethos' Principles of corporate governance.

### 3.1 ELECTION OR RE-ELECTION OF NON-EXECUTIVE DIRECTORS

**VOTE FOR** the proposal of the board of directors or of certain shareholders, however:

**OPPOSE** if one of the following conditions applies:

- a. Insufficient information is provided concerning the nominee or the information does not allow evaluating his expected contribution to the board of directors.
- b. The nominee was implicated in a serious controversy in the past, his activities and attitude are not irreproachable or his election could negatively impact the company's reputation.
- c. The number of mandates held by the nominee is excessive in light of the type of mandates and the maximum limit required by national standards on corporate governance (for Switzerland, see appendix 2).
- d. The nominee has been a member of the board for 16 years or more and there is no valid reason (e.g. he is not a founding member or major shareholder, possesses no specific competencies, etc.) to justify his (re-)election.
- e. The nominee is 75 or older or 70 years or older upon first appointment and there is no substantial justification for his nomination.
- f. The nominee does not meet Ethos' independence criteria (see appendix 1) and the overall board independence is not sufficient with respect of national standards of corporate governance.
- g. The nominee has a major conflict of interest that is incompatible with his role as board member.
- h. The nominee is a representative of a significant shareholder who is sufficiently represented on the board. Under no circumstances should a shareholder control the board.
- i. The nominee has held an executive function in the company during the last three years and the board of directors includes too many executive or former executive directors with respect to national standards of corporate governance.
- j. The nominee has held executive functions in the company during the last three years and he will sit on the audit committee.
- k. The nominee is the chairman of the audit committee or of the risk committee and the company is facing serious problems related to the accounts, the internal control



system, the internal or external audit, in terms of business ethics or climate change risks.

- l.** The nominee is chairman of the audit committee or of the risk committee, is not independent according to the criteria mentioned in appendix 1, and the level of independence of the committee is not sufficient with respect of national standards of corporate governance.
- m.** The member is chairman of the remuneration committee, the elections of committee members are not subject to a specific vote and one of the following is true:

  - One of the point mentioned under point 3.4 is not met.
  - The nominee is not independent according to the criteria mentioned in appendix 1, and the level of independence of the committee is not sufficient with respect of national standards of corporate governance.
- n.** The nominee is chairman of the nomination committee and one of the following is true:

  - The nominee is not independent and the level of independence of the nomination committee is not sufficient with respect of national standards of corporate governance.
  - The board renewal is insufficient.
  - The board composition is unsatisfactory.
  - The board has not enough women compared to market practice with a minimum level of 20% of women without adequate justification.
- o.** The nominee is chairman of the sustainability committee of a company with high greenhouse gas emissions and the company does not have a convincing climate strategy in place.
- p.** The candidate is chairman of a key committee whose functioning is not considered satisfactory.
- q.** The nationality/origin/domicile of the new nominee is overrepresented on the board without justification.
- r.** The new nominee has a nationality/origin/residence other than the country where the company is incorporated and the board does not include any members with nationality/origin/residence in/of the country of incorporation.
- s.** The nominee was employed by the audit firm as partner in charge of the audit of the company's accounts (lead auditor) during the past 2 years.
- t.** The nominee has attended too few board meetings (in principle less than 75%) without satisfactory explanation.
- u.** The nominee is the lead director, but does not meet Ethos' independence criteria (see appendix 1); in particular due to a conflict of interest.



### 3.2 ELECTION OR RE-ELECTION OF EXECUTIVE DIRECTORS

**VOTE FOR** the proposal of the board of directors or of certain shareholders, however:

**OPPOSE** if one of the following conditions applies:

- a. In Swiss companies or in companies listed in Switzerland, the nominee to the board of directors is also a permanent member of the executive management or has operational functions within the company.
- b. Insufficient information is provided concerning the nominee.
- c. The nominee was involved in a serious controversy in the past or does not have a good reputation or his activities and attitude are not irreproachable.
- d. The nominee chairs or will chair the board permanently and the shareholders cannot vote separately on the election of the chairman of the board.
- e. The nominee serves or will serve on the audit committee or the remuneration committee and the shareholders cannot vote separately on the election to the committee.
- f. The nominee chairs or will chair the nomination committee.
- g. The nominee serves or will serve on the nomination committee when the overall composition of the latter does not guarantee the committee's independence (in principle when the majority of its members are not independent or it already includes an executive director).
- h. The board of directors includes too many executive and former executives with respect to national standards of corporate governance.
- i. The overall board independence is not sufficient with respect of national standards of corporate governance and the shareholder structure.
- j. The nominee is a representative of a significant shareholder who is sufficiently represented on the board. In no case should a shareholder control the board.

### 3.3 ELECTION OR RE-ELECTION OF THE CHAIRMAN OF THE BOARD OF DIRECTORS

**VOTE FOR** the proposal of the board of directors or of certain shareholders, however:

**OPPOSE** if one of the following conditions applies:

- a. Ethos could not support the election or re-election of the nominee to the board of directors.
- b. The nominee has operational duties or is also member of the executive management and the combination of functions is not strictly limited in time.
- c. The corporate governance of the company is unsatisfactory and the dialogue with the shareholders is difficult or does not lead to the desired outcomes.



- d. The board of directors refuses to place a validly tabled shareholder resolution on the agenda or to implement a shareholder resolution that received support from a majority of votes during previous general meetings.
- e. The board has not established a nomination committee and one of the following is true:
  - The board renewal is insufficient.
  - The board composition is unsatisfactory.
  - The board has not enough women compared to market practice with a minimum level of 20% without adequate justification.
- f. The board lacks a sustainability committee in a company with high greenhouse gas emissions, and the company has not adopted a compelling climate strategy.
- g. The company's financial performance has been unsatisfactory for several years.

### 3.4 ELECTION OR RE-ELECTION OF THE MEMBERS OF THE REMUNERATION COMMITTEE

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. Ethos could not support the election of the nominee to the board of directors.
- b. The number of mandates held by the nominee is excessive in light of the types of mandates and the maximum limit required by national standards on corporate governance (for Switzerland see appendix 2).
- c. The nominee is not independent according to the criteria in appendix 1 and the committee does not include at least 50% independent members.
- d. The nominee does not meet Ethos' independence criteria (see appendix 1) and the committee includes all board members.
- e. The nominee receives a remuneration that is excessive or not in line with generally accepted best practice standards (see appendix 3).
- f. The nominee holds an executive function in the company.
- g. The nominee was member of the remuneration committee during the past financial year and one of the following points is true:
  - The remuneration system of the company is deemed very unsatisfactory.
  - The transparency of the remuneration report is deemed very insufficient.
  - Unscheduled discretionary payments were made during the year under review.
  - The amounts paid out are not in line with the company's performance or with the remuneration components approved by the annual general meeting.
  - The exercise conditions for a variable remuneration plan were modified in the course of the financial year.



- h. The nominee was member of the remuneration committee in the past when this committee made decisions fundamentally in breach with generally accepted best practice standards.

### 3.5 GROUPED ELECTIONS OR RE-ELECTIONS OF DIRECTORS

**VOTE FOR** if there is no major objection to the nominees standing for (re)election.

**OPPOSE** if the board of directors' proposal on the (re-)election of one or more directors is considered detrimental to the interests of the company and its shareholders.



## 4. Audit Firm

Situations that do not fall under a specific recommendation are to be assessed in light of Ethos' principles of corporate governance.

### 4.1 ELECTION OR RE-ELECTION OF THE AUDIT FIRM

**VOTE FOR** the board of directors' proposal concerning the election or re-election of the external audit firm, however,

**OPPOSE** if one of the following conditions applies:

- a. The name of the audit firm is not disclosed before the annual general meeting.
- b. The audit firm has been in office for 20 years or more or the term of office exceeds the length foreseen by national standards of best practice.
- c. The breakdown of the services provided by the audit firm is insufficient to allow an informed assessment of the auditor's independence.
- d. The fees paid to the audit firm for non-audit services exceed audit fees, absent compelling justification by the company.
- e. The aggregate fees paid to the audit firm for non-audit services during the most recent three years exceed 50% of the aggregate fees paid for audit services during the same period.
- f. The independence of the audit firm is compromised by links between partners of the audit firm and/or the auditors in charge of the audit of the accounts and the company (Directors, major shareholders, audit committee members, senior managers).
- g. The fees paid by the company to its audit firm exceed 10% of the external auditor's turnover.
- h. The lead auditor has recently been severely criticised in connection with his fulfilment of a similar mandate.
- i. The company accounts or the auditing procedure determined by the audit firm have been subject to severe criticism.
- j. The auditor failed to identify fraud or proven weaknesses in the internal control system that have had a significant negative impact on the company's financial results.
- k. The audit report does not include material key audit matters.



## 5. Board and Executive Remuneration

Situations that do not fall under a specific recommendation are to be assessed in light of Ethos' principles of corporate governance.

### 5.1 REMUNERATION SYSTEM AND INCENTIVE PLANS

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The information provided to the shareholders is insufficient to assess the principles, structure and components of the remuneration system (see appendices 3 and 4).
- b. The structure of the remuneration is not in line with generally accepted best practice standards (see appendices 3 and 4).

### 5.2 REMUNERATION REPORT

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The remuneration report does not respect the rules in appendix 3 concerning transparency, structure or the pay-for-performance connection.
- b. The non-executive directors receive remuneration other than a fixed amount paid in cash or in shares.
- c. The use of the remuneration approved is not considered as being in line with the proposal put forward at the previous annual general meeting.

### 5.3 TOTAL REMUNERATION AMOUNT FOR THE BOARD OF DIRECTORS

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The information provided by the company is insufficient to assess the appropriateness of the requested global amount, in particular when the amount requested largely exceeds the amounts paid out.
- b. The maximum potential payout is significantly higher than the amount requested at the general meeting.
- c. The remuneration planned for or paid out to one or several members is significantly higher than that of the peer group.



- d. The proposed increase relative to the previous year is excessive or not justified.
- e. The non-executive directors receive remuneration other than a fixed amount paid in cash or in shares.
- f. Non-executive directors receive consultancy fees in a regular manner or the fees received are too high.
- g. The remuneration of the non-executive chairman largely exceeds that of the other non-executive board members without adequate justification.
- h. The remuneration of the chairman or another board member is higher than the average remuneration of the executive management without adequate justification.
- i. The remuneration of the executive members of the board (excluding the executive management) is excessive or is not in line with generally accepted best practice standards (see appendix 3).

## 5.4 AMOUNT OF FIXED REMUNERATION FOR THE EXECUTIVE MANAGEMENT

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The information provided by the company, in particular with regard to the different components of the fixed remuneration or the number of beneficiaries, is insufficient, in particular when the requested amount largely exceeds the amounts paid out during the past year.
- b. The fixed remuneration planned for or paid out to one or several members is significantly higher than that of a peer group.
- c. The proposed increase relative to the previous year is excessive or not justified.

## 5.5 MAXIMUM AMOUNT OF VARIABLE REMUNERATION (PROSPECTIVE OR RETROSPECTIVE VOTE)

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The information provided is insufficient for shareholders to assess the plans' features and functioning, in particular when the amount requested is significantly greater than the amounts paid during the past year.
- b. The maximum amount calculated on the basis of the information available would make it possible to pay significantly higher remuneration than the remuneration paid by a benchmark group made up of companies of similar size and complexity.
- c. The maximum amount that can be potentially paid out is significantly higher than the amount requested at the general meeting.



- d. The structure and conditions of the plans do not respect generally accepted best practice standards (see appendix 4).
- e. Past awards and the amounts released after the performance/blocking period, described in the remuneration report, do not allow confirmation of the link between pay and performance.
- f. The remuneration committee or the board of directors have excessive discretion with regard to awards and administration of the plan, for example in re-adjusting the exercise price, extension of the exercise period, amendment to the performance criteria or in replacing one plan by another, without prior shareholder approval.
- g. The requested amount does not allow to respect the principles mentioned in appendix 3, in particular the maximum proportion between fixed and variable remuneration.

## 5.6 TOTAL REMUNERATION AMOUNT (FIXED AND VARIABLE) FOR THE EXECUTIVE MANAGEMENT

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The information provided is insufficient for shareholders to assess the relevance of the maximum requested amount.
- b. The total amount calculated on the basis of available information allows for the payment of significantly higher remunerations than those of a peer group.
- c. The maximum amount that can be potentially paid out is significantly higher than the amount requested at the general meeting.
- d. The remuneration structure and the maximum requested amount are not in line with generally accepted best practice standards (see appendix 3).
- e. Past awards and the amounts released after the performance/blocking period described in the remuneration report do not allow confirmation of the link between pay and performance.
- f. The remuneration committee or the board of directors have excessive discretion with regard to awards or have paid out undue remuneration during the previous financial year.



## 5.7 LENGTH OF EMPLOYMENT CONTRACTS AND OF NOTICE PERIODS OF THE MEMBERS OF THE EXECUTIVE MANAGEMENT

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The employment contracts and notice periods exceed one year.
- b. The formulation of the contract allows for the payment of severance payments higher than those prescribed by best practice.
- c. The contracts include non-compete clauses that could lead to excessive payments.



## 6. Capital Structure and Shareholder Rights

Situations that do not fall under a specific recommendation are to be assessed in light of Ethos' principles of corporate governance.

### 6.1 CHANGES IN THE CAPITAL STRUCTURE

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The amendment contravenes the "one share = one vote" principle, unless the company's long-term survival is seriously undermined.
- b. The amendment is intended to protect management from a hostile takeover bid that is compatible with the long-term interests of the majority of the company's stakeholders.

### 6.2 CAPITAL FLUCTUATION MARGIN

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The authorisation allows a capital increase without pre-emptive rights exceeding 10% of the issued capital.
- b. The authorisation allows a capital increase exceeding 20% of the issued capital.
- c. If the capital fluctuation margin is approved, the aggregate of all authorities to issue shares for general financing purposes without pre-emptive rights would exceed 20% of the issued capital.
- d. The main features of an incentive plan that could be financed by the fluctuation margin are not in line with Ethos' guidelines for such plans (see Appendix 4).
- e. The authorisation allows a capital reduction of 5% of the issued capital without adequate justification.
- f. The capital reduction provided by the fluctuation margin is inappropriate in view of the company's financial situation or prospects.
- g. The dilution due to capital increases without pre-emptive rights in the past three years is excessive or the use of the fluctuation margin has been incompatible with the long-term interests of the shareholders.



### 6.3 CAPITAL INCREASE WITHOUT SPECIFIC PURPOSE

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The requested authority to issue shares, with pre-emptive rights, for general financing purposes, exceeds the lesser of 33% of the issued capital and the maximum percentage accepted by local standards of best practice.
- b. The requested authority to issue shares, without pre-emptive rights, for general financing purposes, exceeds the lesser of 10% of the issued capital and the maximum percentage accepted by local standards of best practice.
- c. In case of approval of the request, the aggregate of all authorities to issue shares without pre-emptive rights for general financing purposes would exceed 20% of the issued share capital.
- d. The dilution due to the capital increases without pre-emptive rights in the past three years has been excessive.
- e. The length of the authorisation exceeds the length foreseen by local standards of best practice.

### 6.4 CAPITAL INCREASE FOR A SPECIFIC PURPOSE

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The information provided to shareholders so that they can assess the terms, conditions and the purpose of the capital increase is insufficient.
- b. The purpose of the proposed capital increase (for example an acquisition, merger or a share issue for employee incentive plans) is incompatible with the long-term interests of the majority of the company's stakeholders, with regard to the amount of new capital requested and the financial situation of the company.
- c. The proposed capital increase exceeds the maximum percentage accepted by local standards of best practice, or the company's needs, given the relevance of the pursued objective.
- d. The purpose of the proposed increase includes the possibility of placing the shares with a strategic partner to counter a hostile takeover bid.
- e. The amount requested or the dilution of existing shareholders is too high in light of the stated purpose.
- f. The capital requested is intended to fund a share-based incentive plan the main characteristics of which are incompatible with Ethos' guidelines for such plans (see appendix 4).



## 6.5 SHARE REPURCHASE WITH CANCELLATION OR CAPITAL REDUCTION VIA REIMBURSEMENT OF PAR VALUE

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The principle of equal treatment of shareholders is not respected.
- b. The amount of the repurchase/reimbursement is inappropriate given the financial situation and perspectives of the company.
- c. The company may undertake selective share repurchases.
- d. The shareholders' right to place an item on the agenda of the general meeting is significantly undermined.
- e. The company proposes to cancel shares despite its significant capital need.
- f. The share repurchase replaces the cash dividend.
- g. The ability of the company to pay a dividend is critically undermined by the repurchase of the shares.

## 6.6 SHARE REPURCHASE WITHOUT CANCELLATION

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The amount to be repurchased exceeds a given percentage of the share capital established in accordance with the rules of corporate governance in the relevant country (in principle 10%).
- b. The repurchase price is too high.
- c. The share repurchase replaces the dividend in cash.
- d. The ability of the company to pay a dividend is critically undermined by the repurchase of the shares.
- e. The company can proceed to selective share repurchases.
- f. The length of the authorisation exceeds the lesser of 24 months and the length prescribed by the local standards of best practice.
- g. The purpose of the repurchase is incompatible with the long-term interests of minority shareholders or with those of the majority of the company's stakeholders.
- h. The main features of an incentive plan that will be financed by the shares repurchased are not in line with Ethos' guidelines regarding such plans (see appendix 4).



## 6.7 CAPITAL REDUCTION VIA CANCELLATION OF SHARES

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if the capital reduction is incompatible with the long-term interests of the majority of the company's stakeholders.

## 6.8 CANCELLATION OR INTRODUCTION OF A CLASS OF SHARES

**VOTE FOR** the cancellation of a class of shares and **OPPOSE** the introduction of a new class of shares, unless one of the following conditions applies:

- a. The long-term survival of the company is threatened.
- b. The proposal is contrary to the long-term interests of a majority of the stakeholders of the company.

## 6.9 REMOVAL OR INTRODUCTION OF A LIMIT ON VOTING RIGHTS

**VOTE FOR** the cancellation of a class of shares and **OPPOSE** the introduction of a new class of shares, unless one of the following conditions applies:

- a. The long-term survival of the company is threatened.
- b. The proposal is contrary to the long-term interests of a majority of the stakeholders of the company.

## 6.10 REMOVAL OR INTRODUCTION OF AN OPTING OUT OR OPTING UP CLAUSE

**VOTE FOR** the removal and **OPPOSE** the introduction of an opting out or opting up clause. The replacement of an opting out clause with an opting up clause can be accepted.

## 6.11 INTRODUCTION OR RENEWAL OF ANTI-TAKEOVER PROVISIONS

**OPPOSE** the board of directors' proposal, unless the company provides a convincing explanation that the proposed measure is one-time-only, necessary to preserve the long-term survival of the company and in line with the long-term interests of the majority of the company's stakeholders.



## 7. Mergers, Acquisitions, Spin off, and Relocations

Situations that do not fall under a specific recommendation are to be assessed in light of Ethos' principles of corporate governance.

### 7.1 PROPOSALS FOR MERGERS, ACQUISITIONS, SPLITS AND RELOCATIONS

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. Given the scale of the proposed transaction, the acquisition, merger, spin-off or relocation is not consistent with the long-term interests of the majority of the company's stakeholders.
- b. The information regarding the transaction, in particular the "fairness opinion" issued by a third party is not sufficient to make an informed decision.
- c. The legislation and the corporate governance standards of the new place of incorporation significantly deteriorate the rights of the shareholders and other stakeholders.
- d. The governance of the new company is clearly worse than before.
- e. The new company's practices (or products) do not comply with international standards in respect of human and labour rights or the environment.



## 8. Amendments to the Articles of Association

Situations that do not fall under a specific recommendation are to be assessed in light of Ethos' principles of corporate governance.

### 8.1 VARIOUS AMENDMENTS TO THE ARTICLES OF ASSOCIATION

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. The company fails to provide sufficient information to enable the shareholders to assess the impact of the amendment(s) on their rights and interests.
- b. The amendment has a negative impact on the rights or interests of all or some of the shareholders.
- c. The amendment has a negative impact on the long-term interests of the majority of the company's stakeholders.
- d. The amendment has a negative impact on the governance of the company.
- e. The amendment constitutes a risk for the going concern.
- f. Several amendments are submitted to shareholder approval under a bundled vote and have positive, negative and neutral impacts on shareholders' rights and interests and other stakeholders, but the negative impacts outweigh all others.
- g. The amendment allows the company to organise a virtual general meeting without any adequate justification.

### 8.2 FIXING OF THE MINIMUM AND MAXIMUM BOARD SIZE

**VOTE FOR** the proposal of the board of directors or of certain shareholders unless the number proposed is not adequate for the size of the company and taking into account the local standards of best practice.

### 8.3 MODIFICATION OF THE LENGTH OF THE MANDATE OF DIRECTORS

**VOTE FOR** the proposal of board of directors or of certain shareholders to decrease the length of the mandates unless the proposal threatens the long-term survival of the company.

**OPPOSE** the proposal of the board of directors or of certain shareholders to increase the length of the mandates.



## 8.4 MODIFICATIONS OF THE ARTICLES OF ASSOCIATION RELATED TO REMUNERATION

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. Several amendments are submitted to shareholder approval under a bundled vote and have positive, negative and neutral impacts on shareholders' rights and interests, but the negative impacts outweigh all others.

### Modalities of the vote on remuneration by the general meeting

- b. The proposed voting modalities stipulate a prospective vote on the maximum amount and the remuneration system described in the articles of association does not include caps on the variable remuneration, or these caps exceed those of Ethos (see appendices 3 and 4).
- c. The proposed voting modalities include the possibility to vote on changes to the remuneration retrospectively, even though the maximum amount has already been accepted prospectively.
- d. The board may propose that in case of refusal by the shareholders, a new vote will be held at the same general meeting, even though the second proposal is not known to the shareholders who are not physically present at the meeting.

### Remuneration structure

- e. The structure of the remuneration is not in line with generally accepted best practice standards (see appendix 3).
- f. The non-executive directors may receive remuneration other than a fixed amount paid in cash or shares.
- g. The information provided is insufficient for shareholders to assess the variable remuneration plans' features and functioning (see appendix 4).
- h. The structure and conditions of the variable remuneration plans do not respect generally accepted best practice standards (see appendix 4).
- i. The remuneration committee or the board of directors have excessive discretion with regard to awards and administration of the plan, for example in re-adjusting the exercise price, extension of the exercise period, amendment to the performance criteria or in replacing one plan by another, without prior shareholder approval.

### Reserve for new hires in the executive management

- j. The amount available for new members of the executive management is excessive.



### Non-compete clauses

- k. The articles of association include the possibility to introduce non-compete clauses into employment contracts of the members of the executive management and one of the following conditions is met:
  - The maximum duration of the non-compete is not specified or is excessive.
  - The maximum amount to be paid in consideration of the non-compete is not specified or can be assimilated to a severance payment.

### Maximum number of external mandates for the members of the board of directors and the executive management

- l. The proposed maximum number of mandates is considered excessive, i.e. it does not guarantee sufficient availability to fulfil the mandate with the required diligence (see appendix 2).



## 9. Shareholder Resolutions

Situations that do not fall under a specific recommendation are to be assessed in light of Ethos' principles of corporate governance.

**VOTE FOR** a resolution submitted by an individual shareholder or a group of shareholders if the following conditions apply:

- a. The resolution is clearly phrased and properly substantiated.
- b. The resolution respects the principles of best practice in corporate governance.
- c. The resolution is in line with the long-term interests of the majority of the company's stakeholders.
- d. The resolution complies with the principles stipulated in Ethos' Charter, which is grounded in the concept of sustainable development.
- e. The resolution aims at improving the company's corporate governance or to enhance the company's social and environmental responsibility (see examples in appendix 5).



## 10. Other business

Situations that do not fall under a specific recommendation are to be assessed in light of Ethos' principles of corporate governance.

### 10.1 RESOLUTIONS NOT FEATURED ON THE AGENDA

**OPPOSE** any motion by the board of directors or any shareholders to vote on a proposal under the heading "Other business" (or "Miscellaneous"), if the proposal was not disclosed and described in the agenda before the annual general meeting. When it is not possible to oppose, vote abstain.

### 10.2 ELECTION OR RE-ELECTION OF THE INDEPENDENT REPRESENTATIVE

**VOTE FOR** the board of directors' proposal, however:

**OPPOSE** if one of the following conditions applies:

- a. Insufficient information is provided concerning the nominee.
- b. The nominee does not have a good reputation or his activities and attitude are not irreproachable.
- c. The nominee's independence is not guaranteed.





# APPENDIX



# Appendix 1: Independence criteria for the members of the board of directors

In Ethos' view, in order to be deemed independent, a board member:

- a. Is not an executive director or employee of the company or a company of the same group, and has not held such a position in the past five years.
- b. Is not him/herself or does not represent an important shareholder, a consultant of the company or another significant stakeholder (employees, suppliers, customers, public bodies, the State, etc.).
- c. Has not held executive functions at a business partner, consultant or an important shareholder of the company during the last twelve months.
- d. Has not been involved in auditing the company accounts during the previous five years.
- e. Has not been a partner or a director of the audit firm that audits the financial statements of the company during the previous three years.
- f. Is not a close relative of or does not have business relations with a member of the founding family, an important shareholder or an executive of the company.
- g. Does not have any permanent conflicts of interest.
- h. Does not hold any conflicting office or cross-directorship with another director or with a member of the executive committee.
- i. Does not hold an executive position in a political institution or non-profit organisation to which the company makes or from which it receives substantial donations in cash or kind.
- j. Does not regularly receive any material direct or indirect remuneration from the company except his director's fees.
- k. Has not been sitting on the board or has not been linked to the company or its subsidiaries for more than twelve years (or less, depending on the codes of best practice that apply in the country).
- l. Does not receive remuneration of an amount that could compromise his independence.
- m. Does not receive variable remuneration or options that represent a substantial part of his total remuneration and does not participate in the company's pension scheme (unless participation is compulsory for the members of the board of directors)
- n. Does not hold options with an intrinsic value or shares with a market value that is substantial.
- o. Is not considered non-independent by the company.



# Appendix 2: Maximum number of board mandates

To make sure that board members have sufficient availability, Ethos has set limits on the maximum number of mandates that a person can hold. Generally speaking, when the person does not have an executive activity, he/she will be able to take on more mandates than when he/she has an executive activity.

For the following calculations, all the mandates at companies registered in the Swiss commercial registry (or in a similar registry abroad) are taken into account. The mandates at companies of the same group count as a single mandate. The mandates of chairman of the board in companies subject to an ordinary audit count double.

Ethos is aware that certain tasks within the board of directors can entail a particularly high workload, for example the chairmanship of the audit committee. In these situations, Ethos will assess on a case-by-case basis whether the nominee has sufficient availability.

**Persons without executive functions in a company subject to ordinary audit or a listed company**

| <b>Total number of mandates* of which</b>  | <b>16</b> |
|--|-----------|
| • maximum number of mandates in companies subject to ordinary audit (including listed companies)** | 8         |
| • maximum number of mandates in listed companies   | 5         |

\*The chairmanship of the board of companies subject to an ordinary audit counts double.

\*\*An ordinary audit of the accounts (art. 727 Swiss Code of Obligations, as opposed to limited audit) is mandatory for companies that, for two consecutive financial years, fulfil at least two of the following three criteria:

- Turnover exceeding CHF 40 million
- Balance sheet total exceeding CHF 20 million
- Staff exceeding 250 full-time equivalents



Persons holding an executive function in a company subject to ordinary audit or a listed company

| Total number of mandates* of which  | 5 |
|---|---|
| • maximum number of mandates in companies subject to ordinary audit (including listed companies)**                    | 2 |
| • maximum number of mandates in listed companies (excluding the company where the person holds an executive function) | 1 |

\*The chairmanship of the board of companies subject to an ordinary audit (of which listed companies are part) counts double, therefore a person with an executive function cannot be chairman of another listed company.

\*\*An ordinary audit of the accounts (art. 727 Swiss Code of Obligations, as opposed to limited audit) is mandatory for companies that, for two consecutive financial years, fulfil at least two of the three following criteria:

- Turnover exceeding CHF 40 million
- Balance sheet total exceeding CHF 20 million
- Staff exceeding 250 full-time equivalents



## Appendix 3: Requirements with regard to the remuneration report or system

### Transparency

Approval of the remuneration report (r) or system (s) requires that the following elements should be disclosed in principle\*:

- a. A detailed description of the principles and mechanisms of the remuneration policy (r+s).
- b. A detailed description of each of the components of remuneration, in particular the bonus system and the long-term variable remuneration plans paid in equity, options or in cash (see appendix 4) (r+s).
- c. The amounts of the different components of remuneration at grant, calculated at their market value, as well as their total sum, should be disclosed in a table with separate columns (r).
- d. The detailed description of the degree of achievement of the performance targets for the bonus and the long-term incentive plans. A presentation in the form of a table with separate columns showing the amounts corresponding to the different payments during the year under review as well as their sum total is expected (r).
- e. A summary of the retirement plans of executive management (r+s).
- f. A description of the employment contracts of members of executive management, including the sign-on and termination conditions for each member, in particular in case of change of control or non-compete clauses.
- g. The market value at date of grant of each remuneration component.

*\*Items marked (r+s) apply to the approval of the remuneration report and system, while items marked (r) apply only to the approval of the remuneration report*

### Structure (for the board of directors)

Approval of the remuneration report or system requires that the following rules should apply in principle for the remuneration of the board of directors:

- a. The remuneration of the board members must be in line with that paid at companies of a similar size and complexity.
- b. The remuneration of the non-executive chairman should not significantly exceed that of the other non-executive members without adequate justification.



- c. The remuneration of the chairman or another director should not exceed the average remuneration of the members of the executive management without adequate justification.
- d. Potential year-on-year increases proposed should be limited and duly justified.
- e. The non-executive directors should not receive remuneration other than a fixed amount in cash or shares.

### Structure (for the executive management)

Approval of the remuneration report or system requires that the following rules should apply in principle for the remunerations of the executive management:

- a. The amount of remuneration, granted and realised, should be adapted to the size, the complexity, the performance and the outlook of the company. They should be compared to those paid out by a peer group.
- b. The base salary should not exceed the median of the company's peer group.
- c. The connection between the realised remuneration and the company's performance must be clearly demonstrated.
- d. On-target variable remuneration should not exceed the following values:
  - For the members of the executive management other than the CEO: 100% of the base salary.
  - For the CEO: 1.5 times the base salary.
- e. The maximum variable remuneration (for overachievement of targets) should not exceed the following values:
  - For the members of the executive management other than the CEO: 2 times the base salary.
  - For the CEO: 3 times the base salary.
- f. The higher the variable remuneration, the more it should depend on the achievement of performance objectives that are:
  - Clearly defined, transparent, challenging and compared to a peer group.
  - Measured over a sufficiently long period (in principle, at least three years)

If the above conditions are satisfied or if part of the variable remuneration is based on quantitative and ambitious environmental or social targets, payments in excess of the values stipulated under points d and e above could be exceptionally accepted.

- g. The remuneration of the highest paid person of the executive management must not be disproportionate compared to that of the other members.
- h. Long-term incentive plans paid in shares, options or in cash should be in line with best practice standards (see appendix 4).
- i. Executive remuneration should not systematically increase disproportionately to the remuneration of other employees.



- j. No sign-on bonuses (golden hellos) nor replacement payments without performance conditions for vesting were paid out during the period under review.
- k. No severance payments (golden parachutes) were awarded during the period under review.
- l. There must be a clawback clause regarding variable remuneration acquired in a fraudulent manner or by manipulation of the company's financial statements.

### Working contracts

For the approbation of the remuneration report or system, the following rules on working contracts of executive management should in principle be respected:

- a. The employment contracts and notice periods should in principle not exceed one year or market practice.
- b. The contracts should not include non-compete clauses that could lead to excessive payments.
- c. Executive contracts should not include sign-on bonuses or severance payments.



# Appendix 4: Requirements with regard to variable remuneration (bonus and long-term incentive plans)

## Transparency

Approval of the incentive plans requires that the following elements should be disclosed:

- a. Eligibility to participate in the plan.
- b. The type of award (cash, shares, options).
- c. For share based plans, the capital reserved for the plan.
- d. The performance and vesting conditions and the exercise price.
- e. The total duration of the plan, the performance, vesting and blocking period.
- f. The vesting conditions and number of matching shares (if any) to be received at the end of the blocking period.
- g. The individual caps, preferably as a % of the base salary.
- h. The upside/downside potential of the shares/options awarded conditionally, depending on the level of achievement of performance targets fixed when the plan was launched

## Structure

1. Approval of all variable remuneration plans requires that the, the principles mentioned in appendix 3 as well as the following elements should apply:
  - a. The plan must not be open to non-executive directors.
  - b. Individual awards at grant and at vesting should not be excessive with regard to best practice rules and the company's results. The total amount received from participation in the company's various plans should also be taken into account.
  - c. The plan should not offer excessive or asymmetric leverage.
  - d. The exercise conditions of the plan should not be amended during the life of the plan.
  - e. The plan must include a contractual clause stipulating that in case of fraudulent behaviour or manipulation of the accounts, a clawback is possible.
  - f. The capital reserved for the plan and all other plans (be they broad-based or not) should remain within the limits set by the standards of best practice, i.e. in principle 10% of issued capital in a 10-year rolling period. However, 5% of additional capital can be set aside for employee savings-related plans open to all employees. Capital reserved for executive incentive plans should not exceed 5% of issued capital.



Those limits may be exceeded following an in-depth analysis of the situation, in particular in the case of “start-ups”, growing companies or companies in sectors with long research cycles.

- g. The purchase price of shares for employee savings-related plans should not be in principle lower than 80% of the market price at the date of grant.
- h. The exercise price of the options should not be less than the share price at date of grant.

2. Approval of the short-term incentive plans requires that the following elements should apply in principle:

- a. The bonus payments must be conditional upon the achievement of pre-determined and stringent performance conditions, aiming to align the interests of the beneficiaries with those of the shareholders. Those performance conditions must be in line with the strategic objectives of the company and set at the beginning of the period.
- b. The annual bonus must vary in line with company performance. The amounts effectively paid out must be justified in light of the degree of achievement of the different performance targets fixed at the beginning of the period.
- c. Part of the annual bonus must be deferred (in form of restricted shares for example) in particular when the annual bonus represents the majority of the variable remuneration. The blocking period must be sufficiently long (in principle 3 years).
- d. When part of the bonus is paid in restricted shares or options, additional awards (matching shares) at the end of the blocking period should only be linked to the achievement of additional performance targets.

3. Approval of the long-term incentive plans requires that the following elements should apply in principle:

- a. The incentive plans with narrow eligibility should vest subject to the achievement of pre-determined and sufficiently stringent performance targets to align the interests of the beneficiaries with those of the shareholders.
- b. The targets should be both absolute and relative compared to company peers. This is especially important when the grants include a high leverage potential at the end of the performance period. In case of serious absolute or relative underperformance, the number of shares released and/or exercisable options should be reduced to nil.
- c. The period of performance testing or blocking should be long enough (in principle at least three years).
- d. The amounts effectively paid out at the end of the performance period should be justified in light of the degree of achievement of the different performance objectives fixed at the beginning of the period.



# Appendix 5: Shareholder Resolutions

Ethos recommends supporting shareholder resolutions that aim at improving corporate governance or enhancing the social and environmental responsibility of the company.

In general, Ethos approves, among others, resolutions such as those mentioned below. However, Ethos assesses each resolution in its specific context, which could lead to different voting recommendations.

## Corporate Governance Resolutions

- a. Separate the functions of Chairman and CEO.
- b. Introduce annual elections for directors.
- c. Introduce majority vote for director elections.
- d. Report on political contributions and lobbying.
- e. Elect an independent director with confirmed environmental expertise.
- f. Link the grant of options to the achievement of performance targets.
- g. Adopt an annual “Say on Pay”.
- h. Link variable remuneration to clearly established and disclosed performance criteria.
- i. Remove classes of preferred shares.
- j. Allow minority shareholders to propose candidates for the board of directors.
- k. Align the political contributions of the company with its values.

## Environmental Resolutions

- a. Prepare a sustainability report including the targets set by the company with regard to greenhouse gas emissions reduction.
- b. Prepare and adopt an annual “Say on Climate”.
- c. Adopt quantitative targets for reducing total greenhouse gas emissions from the company's operations, supply chain and products, in particular if the targets are consistent with limiting the average global temperature increase to 1.5°C .
- d. Report to shareholders on the financial risks related to climate change and its potential impact on long-term shareholder value.
- e. Report on long-term environmental, social and economic risks associated with the oil extraction from oil sands.
- f. Stop oil extraction from oil sands.
- g. Report on risks related to unconventional oil extraction and gas production.
- h. Report on risks related to shale gas extraction.
- i. Report on risks related to deepwater drilling.



- j. Report annually on the measures taken to minimise deforestation due to palm oil production.

### Social Resolutions

- a. Prepare a report on diversity within the company.
- b. Establish a human rights committee.
- c. Disclose company policies on lobbying.
- d. Establish a policy aiming at maintaining affordable prices for medicines.





# CORPORATE GOVERNANCE PRINCIPLES



# 1. Accounts, Dividend and Discharge

## 1.1 ANNUAL REPORT

The annual report enables shareholders and other stakeholders to follow a company's financial situation and to be informed of corporate strategic orientations. It gives the board of directors the opportunity to present and comment upon its activities during the financial year and to put forward future strategies and objectives. Consequently, the quality and sincerity of the information contained in this document are crucial to ensure investor confidence.

During the annual general meeting, the annual report is presented to the shareholders, who may subsequently call upon the board of directors and address queries or express concerns. Afterwards the annual report is generally put to the vote of the shareholders. In some countries it is accompanied by a request to discharge the board of directors or the Supervisory board for their management of the company during the year under review.

The annual report traditionally includes financial information at company and group level. It should also include the management commentary, as well as extra-financial information, pertaining to the company's corporate governance as well as environmental and social responsibility.

### Management commentary

The management commentary is a complement to the financial statements and should be published in a separate chapter of the annual report. In the commentary, the management should disclose important information regarding the company's

financial situation, as well as the company's strategies and objectives.

In particular, the commentary should include information on the company's activities, strategic orientation, resources, major strategic risks, relations with stakeholders, actual results compared to objectives, main financial and non-financial indicators and perspectives of the company.

### Information on Corporate Governance

More and more companies are including a chapter dedicated to corporate governance, which has the advantage of combining all relevant information. In most countries, the standards with regard to corporate governance disclosure are similar.

In Switzerland, for instance, listed companies should describe their corporate governance practices in a concise and intelligible way. They should present the shareholding structure of the company, the capital structure, the composition and functioning of the board of directors and the executive management, anti-takeover measures if any, information about the external auditor, as well as the company's information policy.

### Information on environmental and social responsibility

Corporate environmental and social responsibility is increasingly integrated into the considerations of investors when analysing the companies in which they are invested or wish to invest. Chapter 2 of this document presents in detail Ethos'



expectations regarding corporate sustainability reporting.

## 1.2 FINANCIAL FREPORT OF A COMPANY AND GROUP

The financial report of a company, be it a separate or integral part of the annual report, is the document whereby shareholders and other stakeholders can obtain a comprehensive overview of the company's financial situation, past developments and future prospects.

The financial statements (balance sheet, income statement, shareholders' equity, cash flow statement, notes to the financial statements, etc.) fulfil two purposes. First, they trace the company's financial evolution; secondly, they provide input for share valuation and for investor decisions concerning the acquisition, retention, sale and exercise of the rights and obligations attached to such shares.

Accounting rules therefore require a presentation of the company's financial statements according to the "true and fair view" principle. The integrity of financial information is a prerequisite to the sound functioning of financial markets. Thus, companies should publish in due time all relevant financial statements in conformity with internationally accepted accounting standards (e.g. IAS/IFRS or US-GAAP standards). Furthermore, additional information recommended by codes of best practice in corporate governance should also be available. Comparability of the financial statements published by companies is of paramount importance to investors. The adoption by companies of standardised accounting practices has brought an answer

to the problem, but there are still differences among companies as to the implementation of those practices and the quality and extent of the information disclosed.

The consideration of future events is a key element of accounting standards to ensure that the accounts do not misrepresent the value of a company's assets. Under international accounting standards, the value of assets depends on their future ability to generate cash flows. It is now generally accepted that climate change poses physical, transitional and legal risks for businesses. When preparing their financial statements, companies make assumptions (e.g., about the life of assets and the revenues they will generate) that allow them to value balance sheet positions and to recognise the related costs (depreciation and amortisation). Ethos expects that climate risks and their impacts on the financial statements are incorporated into the assumptions made and that these are disclosed in a transparent manner in the notes to the financial statements. Indeed, when a company declares that it wants to reduce its emissions in a way that is compatible with a warming of 1.5°C, the assumptions used in the preparation of the financial statements must take into account the costs of achieving such an objective. They must also consider the impact on the company's operations if a higher warming scenario were to occur. In addition, the report must include a statement that the directors have taken climate risk into account when signing the financial statements. Finally, the report must disclose how the accounting assumptions were tested against credible eco-nomic scenarios that are consistent with achieving zero net carbon emissions by 2050. Reports that do not take these material impacts into account may not meet the fundamental accounting principle



of "true and fair view" by misrepresenting information and therefore misdirecting capital for both the company's management and shareholders.

A company's financial statements must be disclosed to its shareholders at least once a year; however, they are often issued on an interim basis. Shareholders should receive financial statements simultaneously to ensure the principle of equal treatment. In addition, they should receive them sufficiently in advance to vote knowledgeably at annual general meetings. The efficient and timely publication of results following the closure of accounts is paramount to the principles of best practice in corporate governance.

In most countries, companies are required to submit their annual accounts, duly certified by an external audit firm appointed by the shareholders, for approval at the annual general meeting. Even where the company's articles of association or national legislation do not require shareholder approval of the company report and accounts, it is nevertheless best practice for the board to request such approval at the annual general meeting. In fact, it is better if the general meeting is allowed to vote separately on the annual report and the financial statements.

### 1.3 ALLOCATION OF INCOME AND DIVIDEND DISTRIBUTION

The auditors comment on the board of director's proposals concerning the allocation of income before they are submitted to the shareholders. In general, the board proposes that the net income be used to set up reserves and to pay out a dividend.

Sometimes, instead of paying a dividend, or in addition thereto, Swiss companies propose to reimburse part of the nominal value of the shares. This is a fiscally attractive transaction for the shareholders, because it is not subject to income tax. In other cases, companies opt for share repurchase plans to return excess capital to the shareowners instead of (or in addition to) paying a dividend (see point 6.3. of the corporate governance principles). Share buybacks cannot be considered as equivalent to a dividend as they are a reimbursement of a part of the capital to shareholders. Since 2011, Swiss companies may also distribute cash (as a dividend) from a reserve of paid-in capital (share premiums or agio) established since 1 January 1997. These dividends are exempt from Swiss withholding tax and, for Swiss resident shareholders, from income tax.

Since the entry into force of the federal law on tax reform and AHV financing (STAF) on 1 January 2020, listed companies distributing dividends from reserves from capital contributions (tax-free) generally have to distribute an equivalent taxable dividend from retained earnings.

The dividend should be commensurate with the company's financial situation and future prospects. When needed, shareholders can ask for additional information.

Income distribution policies depend on several factors and therefore vary according to the country, the economic sector and the company's stage of development. Start-ups and growing companies may deem it preferable to allocate income to the financing of their development rather than to pay a dividend.

Given that the total shareholder return (TSR) is equal to the sum of the dividend yield and the annual share price growth, many



companies consider it important to pay a stable dividend, and trust that the increase in share value will enhance the shareholders' long-term returns.

One of the means of evaluating income distribution is the pay-out ratio, which is defined as the proportion of consolidated net income distributed in the form of a dividend and/or reimbursement of the nominal share value. The pay-out ratio therefore depends on the economic sector to which the company belongs and the type of company. Lower pay-out ratios may be justifiable in the case of high-growth companies that set aside profits for future investment. However, mature companies are expected to offer higher pay-out ratios. The ratio would nevertheless remain comparatively lower in countries where companies pay low dividends traditionally or for fiscal reasons.

The pay-out ratio and any fluctuations in it must be explained by the company. Investors, especially institutional investors, need regular inflows of cash and therefore appreciate the payment of even a modest dividend. Therefore, a "zero-dividend" policy cannot be approved in the long-term, unless the company finds itself in a particularly difficult situation.

Some companies replace the payment of a dividend by the operation of share buyback programmes. Contrary to a dividend, this is equal to a reimbursement of a part of the capital to investors, which have to sell their shares to benefit from such programmes while at the same time decreasing their participation, however this is not optimal for long-term investors who in addition incur transaction fees (see 6.3.1 principles of corporate governance).

Ethos considers that it is normal to reduce or withhold the dividend in case companies

post losses. Given that many companies opt for a stable dividend policy, it may nevertheless be acceptable, in the case of exceptional losses, for a company to pay the dividend by releasing the amount from its reserves, provided that it has sufficient liquidity to do so. This practice cannot be justified, however, in the case of recurrent or substantial operational losses resulting, for example, from strategic problems for the company, or from an economic downturn. Under such circumstances, paying out the dividend would contribute to drain the company's reserves and give the shareholders a false impression of its real financial situation.

As a rule, the board of directors' proposals for the allocation of income and dividend distribution should appear on the agenda as an item that is distinct from the request for approval of the accounts and discharge of the board of directors. Although there are many cases where the law or the articles of association of the company do not require the shareholders to vote on income allocation, codes of best practice consider that shareholders should give their opinion in a matter that is of direct concern to them.

## 1.4 POLITICAL AND CHARITABLE DONATIONS

### Political donations

In general, company funds should not be used for political purposes, like the financing of political campaigns or elections. There are however countries where companies are allowed to make such donations, not only directly to political candidates or parties, but also to organisations that finance these candidates or parties. In this case, companies



must demonstrate greater transparency, not only in disclosing the donations, but also put in place rules and procedures regarding the allocation of contributions, in the company's code of conduct.

Where political donations are made, it is important that they are in line with the strategic interests and values of the company and its stakeholders. Such donations must not just serve the short-term interests of directors and certain shareholders. In some countries, the maximum authorised donation is put to vote. The donations must be disclosed and justified in the company's annual report or on the website so that shareholders can evaluate the use of funds.

Political donations are classified by type. There is a distinction between direct donations (to an individual candidate or political party) or indirect donations (to business federations or lobbying organisations).

### Charitable donations

With the understanding that a company has a social responsibility toward society in general, a company may make charitable donations. To avoid conflicts of interest, the companies should also establish precise and transparent attribution procedures and rules and procedures, which should be written in their code of conduct. These donations, approved by the board, should be subject to a formal and transparent selection procedure and approved by the board of directors.

## 1.5 DISCHARGE OF THE BOARD OF DIRECTORS

The discharge (or “*quitus*” in France) granted to the board is all too often considered a mere formality. Yet, from the perspective of corporate governance, shareholders should appreciate the true value of this procedure. Discharge constitutes formal acceptance of the facts presented. As such, it is the shareholders' endorsement of the board of directors' management of the company affairs during the financial year under review.

In Switzerland, for example, discharge is one of the shareholder general meeting's inalienable rights. It constitutes a declaration that no legal proceedings shall be instituted against the discharged body for its conduct of business during the period under review. The approval of the annual report and accounts does not automatically entail discharge.

Discharge is valid only for the facts revealed, and exempts the discharged members of the board from prosecution by the company for gross negligence. Shareholders who grant a discharge lose their right to obtain reparation for indirect prejudice. In Switzerland, any shareholders who withhold the discharge retain their right to file lawsuits against the directors for damages within a period of six months.

Generally, the discharge is restricted by law to the members of the board of directors. A situation may arise, however, where the discharge may be extended to other persons closely connected with the management of the company, such as executives and trustees.

Persons who have participated, in any way whatsoever, in the management of corporate affairs should not vote on the discharge to



the board of directors. If a person is excluded, then so are his representatives. The overriding doctrine dictates that a legal entity owning shares in the company is prevented from voting the discharge if the said entity is controlled by a member of the board requesting discharge.

Given that the discharge entails a formal acceptance of revealed facts and a release by the shareholders of the board of directors for the management of the company, Ethos considers that the principle of discharge should therefore also be extended to the management of the extra financial challenges of the company. The shareholders should therefore not grant the discharge when certain elements of the governance of the company constitute a significant risk for the company's shareholders and other stakeholders.

Refusal to grant discharge is therefore also justified when: -

- The board of directors has made decisions that constitute a major environmental/social risk or fails to recognise the major environmental/social issues facing the company;
- The company is involved in an accident that has caused serious harm to the lives or health of employees, the communities in which it operates, or the natural environment;
- The company is substantively accused of systematic violations of internationally recognised human rights of employees, local communities or the company is complicit in such violations along the supply chain;
- The company refuses to acknowledge the negative impact of some of its products or

operations on humans or the natural environment.



## 2. Sustainability

### 2.1 SUSTAINABILITY REPORT

Corporate environmental and social responsibility is increasingly integrated into the considerations of investors when they analyse the companies in which they are invested or wish to invest. For investors, including Ethos, corporate environmental and social responsibility is part of the foundation of long-term shareholder value.

In this respect, non-financial information is of particular importance and the sustainability report is an important communication tool enabling companies to publish information about their sustainable development strategy and the basis of their environmental and social policy in a transparent manner.

In order to establish an internationally standardised framework, sustainability reporting standards (GRI or SASB) have been developed so that companies can adopt a standardised approach to measuring and reporting their economic, environmental and social performance. These standards also allow stakeholders to more effectively evaluate and compare the sustainability reports of different companies.

In Switzerland, listed companies will have to submit their sustainability reports to a consultative vote as of 2024 or 2025, depending on the entry into force of the counter-proposal to the initiative for responsible multinationals.

Ethos' voting guidelines have been adapted in order to clarify the relevant criteria for the approval of the sustainability report. In particular, Ethos expects the sustainability report to be prepared in accordance with a recognised extra-financial reporting standard

(GRI, ESRS, ISSB or SASB) and to be verified by an independent third party. The sustainability report must cover all material issues specific to the company with specific targets for each issue and contain quantitative indicators to measure progress over several years (minimum three years). In particular, Ethos may reject the sustainability report if the company does not systematically meet its objectives or if there is a deterioration of key indicators over a period of three years. Finally, the report must be published sufficiently in advance of the general meeting so that stakeholders have time to read it.

### 2.2 SAY ON CLIMATE

In recent years, Say on Climate resolutions have appeared on the agendas of the general meetings of listed companies, particularly at the request of large institutional investors. This initiative was initially launched by activist investor Chris Hohn, through the Children's Investment Fund Foundation. The Say on Climate calls for greater transparency in corporate climate strategy and reporting and a non-binding annual vote by shareholders at the Annual General Meeting (AGM).

The Say on Climate encourages companies to disclose CO<sub>2</sub>e reduction targets, climate action plans, measures to reduce emissions as well as climate-related risks and opportunities in accordance with the Task Force on Climate-related Financial Disclosures (TCFD) reporting framework. It thus aims to promote robust net-zero



transition plans and provide investors with the opportunity to vote on these climate action plans.

There has been a significant increase in the number of climate strategies and reports being proposed by boards of directors and submitted to a consultative vote of the shareholders, primarily among European and Australian companies.

The Say on Climate may vary in form depending on the company and the market, but in substance, the resolutions should include at a minimum:

- An annual statement of greenhouse gas (GHG) emissions,
- A plan to manage and reduce these emissions,
- A non-binding annual vote on this plan at the AGM.

Ethos is in favour of the organisation of such votes at the AGM and asks companies, in particular those with the highest GHG emissions, to submit their climate strategy and their climate report for shareholder approval in a Say on Climate vote.

A distinction is made between the vote on the climate strategy and the climate report. While the vote on climate strategy focuses on the objectives and measures to be taken to achieve the climate transition, the climate report deals with the progress made so far in reaching the objectives set.

With respect to company climate action plans, several key elements should be included, as follows:

- Publication of CO<sub>2</sub>e emissions in accordance with the GHG protocol,
- CO<sub>2</sub>e emission reduction targets consistent with a maximum warming of 1.5°, covering all its direct and indirect emissions (scopes 1, 2 and at least 80% of scope 3) and verified or being verified by a recognised organisation,
- Publication of interim reduction targets,
- Appropriate measures to be taken to reduce its CO<sub>2</sub>e emissions or their contribution to the achievement of its objectives,
- Disclosure of the capital expenditure required (Capex) to achieve its CO<sub>2</sub>e reduction targets,
- Commitment to publish an annual report on the implementation of its strategy.



## 3. Board of directors

### 3.1 BOARD DUTIES

The board of directors must be an active, independent and competent body that is collectively accountable for its decisions to the shareholders that have appointed it. In Switzerland, the competencies of the board are defined in company law (Art. 716 CO).

In general, Ethos considers that the board has the following duties:

- Play a predominant role in defining the company's strategic orientations and its implementation.
- Take the necessary measures to meet the targets set, control risk.
- Monitor the implementation and the results of the strategy.
- Be responsible for the company's organisation at the highest level (this includes the appointment, monitoring, remuneration and succession planning of senior management).
- Ensure that the accounting and audit principles are respected. Assess the quality of the information provided to shareholders and the market when preparing the annual report and accounts for which they are responsible.
- Make sure that the company is compliant with corporate governance best practice and disclose it to the shareholders.
- Integrate the notion of environmental and social responsibility in the company's strategy and risk management policy (see point 3.2).
- Organise and convene the annual general meeting and implement its decisions.
- To carry out its mandate actively, independently and competently, the board must have a number of characteristics:
- It must have an adequate composition (see point 3.4 below).
- It must receive exact and relevant information in a timely manner.
- It must have access to the advice of independent consultants if necessary.
- It must establish key committees in charge of certain matters, in particular audit, risk, nomination, remuneration and sustainability.
- It must regularly assess its overall performance and the individual performance of each board member (in particular the Chairman) and of the CEO.
- It must be regularly renewed.

### 3.2 BOARD DUTIES WITH REGARD TO SUSTAINABILITY

Institutional investors have a fiduciary duty to integrate sustainability criteria into their investment policies as well as in their voting decisions at general meetings. As such, investors expect boards of directors to take sustainability criteria into account in the decision-making process. In particular, directors have a fiduciary duty to act in good faith, with the care and loyalty necessary to promote the long-term success of the company with a view to creating long term value. The boards of directors is therefore accountable of the governance of sustainability in the company and its integration into strategy, innovation, and risk



management. The board must consider the short- and long-term interests of the company and its stakeholders to create a positive material impact on society and the environment.

In general, Ethos considers that the board of directors has the following duties:

- To identify, address and report on environmental and social risks relevant to the company;
- To oversee the company's approach to managing human rights and modern slavery issues in its operations and supply chain;
- To ensure that the risks related to the safety of personnel in its operations and its supply chain are identified and mitigated;
- To assess the impact of the company on the environment and the biodiversity and determine the adaptation measures to respect the relevant planetary boundaries
- To assess the impact of the company in terms of climate change and determine the adaptation measures to be taken to meet the needs of a net zero economy by reducing greenhouse gas emissions

### 3.3 BOARD STRUCTURE

Companies may adopt a board of directors including both executive and non-executive directors or a Supervisory board including non-executive directors only and an Executive board. Most countries opt for a system where the board may include executive and non-executive members. However, in Germany and Austria, a system of governance with supervisory board is mandatory. In France and in the Netherlands,

the law allows companies to choose between the two systems.

In countries where it is mandatory to establish dual structures comprising a supervisory board and an executive board (Austria and Germany), the supervisory board does not include executive members, who can only sit on the executive board. The advantage of this system is that there is clear separation of the roles of Chief Executive Officer and Chairman of the board of directors (see 3.8 below).

### 3.4 BOARD COMPOSITION

The composition of the board of directors is fundamental to ensure its good functioning. The board should make sure that its composition is adequate in terms of competencies, independence, diversity and availability of its members.

#### Competencies

The board should have an appropriate balance of competencies, education and professional backgrounds, so as to be able to discharge its multiple duties in the best interests of the company. They are frequently chosen for the position they occupy in economic, scientific, legal, political and academic circles. Similarly, they may be selected to represent certain interests such as those of a major shareholder, the State or the employees.

A board should include members with a wide range of skills, particularly in terms of knowledge of the industry, financial management, auditing, or operational management of a company of similar



complexity. In addition, given the increasing importance of the digital economy, digitalisation skills are also becoming crucial for companies and should be present and integrated at board level. Finally, sustainability expertise is an undeniable asset, considering the board's duties in the area of sustainability (point 2.2 above).

In light of the complexity of their mission and the responsibility it entails, directors should receive induction on nomination, as well as regular training during the course of their mandate.

### Independence

The board should include sufficient directors who are independent from management in order to carry out its duties with objectivity and in the interests of the shareholders.

Generally speaking, the board of directors consists of three types of directors:

- Independent directors, whose sole connection with the company is their board membership.
- Affiliated directors, who are non-executive directors that do not fulfil the requirements for independence stipulated in point 2.5.
- Executive directors, who are employed in an executive capacity by the same company.

To be considered sufficiently independent, the board should include at least 50% independent directors (more than 50% in cases where the offices of Chairman of the board and CEO are held by the same person).

Companies with one major shareholder (or group of shareholders) must be viewed differently. This is especially true of “family” businesses in which the founder and/or

family members are actively involved at the financial and management levels.

In such cases, the composition of the Board of directors must be analysed keeping in mind the company's history. It should however be noted that overrepresentation of important shareholders on the board is not desirable. This could lead to a major shareholder controlling not only the general meeting but also the board, which carries serious risks for minority shareholders and other stakeholders of the company.

In countries, such as Germany and France, the law requires the presence of directors who represent either employees or employees holding company shares. In Germany, half the members of the Supervisory board of a company with a payroll of over 2,000 must represent the employees. These members may be employees or union representatives.

In France, the board of directors must appoint employee representatives when the employees collectively own 3% or more of the company's share capital. Furthermore, the board of a French company may include employee representatives (a maximum of five or one third of board members).

### Diversity

Diverse skills and sufficient independence are essential for an effective board. Board diversity is also an important element, as it enhances the quality of board deliberations.

It is thus important to ensure that the board includes not only women, but also directors of different ages, racial or ethnic backgrounds, backgrounds or professional experience, particularly in industries and



regions of the world where the company has significant operations.

Expectations for racial and ethnic representation at the board and senior management level are increasing, particularly in the United States, where in August 2021 the Securities and Exchange Commission (SEC) approved the Nasdaq Board Diversity Rule, which requires at least two directors from diverse backgrounds, including one woman and one member of an underrepresented or LGBTQ+ minority. In the United Kingdom, the Parker Report recommends increasing ethnic diversity on boards by proposing that every FTSE 100 board have at least one director from an ethnic minority by 2021 and every FTSE 250 board by 2024. In countries where the collection of data on racial and ethnic origin is prohibited, boards of directors should find other ways to promote diversity and inclusion.

## Gender

Over the last two decades, the under representation of women in senior management, executive and board positions in listed companies has been a much debated issue. It is obvious that the achievement of equal representation in the workplace is a long-term undertaking that requires the establishment of structures that encourage and allow women to climb the corporate ladder. The feminisation of boards is a very serious challenge for companies that are under increasing pressure from civil society and, as a consequence, from the legislator asking for more women directors on corporate boards.

Faced with the realisation that self-regulation alone could not effectively

promote the appointment of women to boards of directors, several European Union member states have for several years adopted a quota for female representation or gender representation in their legislation. The first to take this step was Norway in 2003, followed by several other countries in 2011. The positive effect of quotas has been demonstrated in countries that have adopted them. In June 2022, the European Parliament adopted a directive requiring large European companies to have 40% of their non-executive board members or 33% of their total board members be women by mid-2026. Member states will have to transpose the directive within two years of its adoption.

In Switzerland, the revised Code of Obligations also contains a quota provision, which came into force on 1 January 2021. Companies subject to an ordinary audit have 5 years to comply with the 30% quota with regards to the board of directors and 10 years to comply with the 20% quota for the executive committee. Companies that do not reach those quotas will have to provide an explanation and the measures taken to reach the target (comply or explain).

To reach those diversity targets, the listed companies must urgently put in place policies encouraging the professional advancement of women. To reach the executive level, women need to be able to progress in the hierarchy. The implementation of concrete strategies and tools to achieve gender diversity in teams and avoid the regular decrease of the number of women in higher positions should be a priority for the departments of human resources.



### Age

It is important that the board has a good range of different ages among the directors. Too many directors over the legal retirement age present problems for succession and renewal of ideas and competencies. In fact, younger nominees can have a more modern and innovating view of business. The boards should therefore include a diversity of directors in terms of age, with particular emphasis on the board's succession plan. In order to ensure regular renewal of the board, certain companies set age or term limits for board membership (see point 3.11).

### Diversity of origin

The presence of directors with extensive experience of the company's country of domicile is fundamental. So is the presence of a certain number of directors of other origins or having lived or worked in other regions of the globe, especially in countries where the company has important operations and business connections. Their contribution becomes increasingly important in light of the globalisation of the economy.

### Availability

In order to fulfil their duties with the required diligence, in particular in a period of crisis, the directors should have sufficient time to devote to their directorships.

It is therefore important to pay particular attention to the overall time commitments of the directors, in particular when these directors also perform executive duties in a company (see point 3.11).

## 3.5 BOARD SIZE

While the overall composition of the board is an essential consideration, so too is its size. A board with too many members can become cumbersome, but a board that is too small may lack competent members and diversity and be unable to establish separate key committees made up of sufficient independent and different persons, which leads to a risk for the company and its minority shareholders. What constitutes a reasonable number of members depends on the specific size and situation of each company. For large listed companies, Ethos considers that a reasonable number would be between eight and twelve members; for medium-sized companies, it would be between seven and nine members, and for small companies between five and seven.

Experience has shown that when the board is too small (four members or less), the directors tend to act in an executive capacity. In such cases, the distinction between management and oversight could become blurred, making it more difficult to ensure a division of responsibilities at the head of the company. Finally, sustainability expertise is a definite asset, considering the board's sustainability duties (point 2.2 above).

## 3.6 INDEPENDENCE OF DIRECTORS

An independent director must be free of any link with the company that could compromise his objective participation in the board's activities and not exposed to conflicts of interest. He/she must be capable of expressing disagreement with other directors' decisions if he/she considers that they run counter to the interests of the shareholders.



A person's independence is fundamentally a question of character, and it is often difficult for shareholders to assess this element, especially in the case of a new nominee. It is thus necessary to evaluate the independence of board members against generally accepted objective criteria.

According to Ethos, a director is considered independent when all criteria listed in appendix 1 of Ethos' voting guidelines are met.

The laws and best practice codes of many countries consider that a director is no longer independent when his/her mandate exceeds a certain duration. For example, the European Union, France and Spain foresee a limit of 12 years, Finland has set a limit of 10 years, while Great Britain and Italy are stricter with 9. In Germany, there is no specific limit in the best practice code or in the law. In the Netherlands, the mandate duration is not considered as an affiliation reason, but the code of best practice stipulates a maximum mandate duration of 12 years for directors of listed companies. In the United States, the mandate duration is not a condition of independence.

Concerning a significant shareholder and their representatives, who are thus non-independent directors, the shareholding threshold required for the shareholder to be considered significant varies. A threshold of 10% is used in France and the Netherlands to consider a shareholder as significant, and thus as non-independent. Great Britain and Spain are stricter with a threshold of 3%. In the United States, a shareholder is considered as non-independent when he holds more than 50% of the voting rights in the company.

Decisions on the independence of directors must be guided by the above criteria of best

practice, but the information provided by the company on its directors is crucial. To this effect, some codes of best practice require companies to make substantiated statements of independence regarding the directors.

### 3.7 COMMITTEES OF THE BOARD DIRECTORS

#### General characteristics

Specialised board committees are a fundamental aspect of corporate governance. Indeed, because the board of directors performs a large number of widely varying tasks, the issues to be dealt with are complex and the directors cannot all be expected to have the same degree of expertise in all fields. Furthermore, the board will gain in efficiency if the work is shared among its members; this is important in larger and more diversified companies. Lastly, in some areas in which conflicts of interest are likely to arise (audit, remuneration, nomination), independent directors play a key oversight role.

The establishment of separate and focused board committees is one means of addressing such concerns. However, these committees do not replace the board with regard to matters that fall within the remit of the board as a whole.

The specific tasks of each committee depend on the number of committees in a company and may vary from country to country. Nevertheless, it is possible to identify the general trends described below.

Each company can establish as many committees as it deems necessary for the conduct of its business. Codes of best



practice nevertheless recommend a minimum of three committees (hereinafter referred to as “key committees”): the audit committee, the nomination committee, and the remuneration committee.

The Swiss Code of Obligations requires listed companies to set up at least a remuneration committee, whose members are elected annually and individually (see introduction to this document).

Large companies sometimes set up other committees, for example the Chairman’s committee, the corporate governance committee, the risk committee, the compliance committee (which ensures the company’s compliance with the laws, regulations and statutory requirements), or the sustainability committee in charge of the company’s environmental and social strategy. The corporate governance committee is generally responsible for evaluating the size, organisation and operation of the board and its committees for ensuring that the board maintains good quality engagement with the shareholders and that the company abides by the law and all relevant regulations.

Each committee should consist of at least three but not more than five members, in order not to become unwieldy. The list of members and the name of the chairman of each committee should be made public. The most efficient way of doing this is to post the information on the company’s website, which should be regularly updated.

Matters relating to audit as well as the nomination and remuneration of directors and other senior executives require independent judgment that is free of conflicts of interest. They should therefore be entrusted to board committees

comprising only non-executive and mostly independent members.

### Audit committee

The board of directors is responsible for the integrity of the financial information disclosed by the company and must therefore set up an audit committee whose tasks are the following:

- Oversee the accounting process and approve the assumptions made by senior management (particularly those relating to the impact of climate change);
- Be responsible for the reliability and integrity of the company’s accounting policies, financial statements and reporting.
- Ensure the effectiveness and coordination of internal and external audits.
- Verify the independence of the external auditor.
- Authorise the external auditor to provide non-audit services and to approve the corresponding amount.
- Monitor the company’s internal control and risk management systems.
- Review and approve the internal and external audit reports and put in place the required improvements.
- Conduct a critical survey of the financial report and accounts and issue a recommendation to the board of directors concerning their presentation to the annual shareholders meeting.

The performance of these tasks has led to increasingly professional audit committees whose members have extensive and up to date expertise in accounting, control, and auditing, as well as in-depth knowledge of the company’s industry. The audit committee members are in principle independent and



should have sufficient time to carry out their assignments with due diligence.

In order to avoid conflicts of interest, audit committee members should in principle be independent. Time limited exceptions can be made where it is in the company's best interest to rely upon the competencies and experience of a non-independent director. Notwithstanding the foregoing, the audit committee must never comprise executive directors, or persons having acted in an executive capacity in the previous three years.

Members of the audit committee must have the opportunity to meet with and monitor the people responsible for the establishment and the control of the company's accounts in the absence of executive directors.

### Nomination committee

The role of the nomination committee is to identify and propose the most suitable nominees for election to the board and for appointment to senior management positions. It therefore plays a crucial role in ensuring a balanced board of directors and efficient senior management. It also establishes the succession planning for the CEO, the company's top executives and the members of the board. In order to propose the best nominees, the committee must adopt selection procedures that take into consideration the company's specific needs. These procedures must be rigorous, transparent and disclosed to the shareholders. Furthermore, it falls to this committee to regularly assess the appropriateness of the size and composition of the board of directors.

Lastly, the nomination committee must establish a regular process by which to

appraise the performance of board members and of the company's executive management. In order to guarantee objectivity, this task can be carried out in co-operation with an external consultant. The members of the nomination committee must in principle be non-executive directors mostly independent.

### Remuneration committee

The remuneration committee determines the company's remuneration policy. It is also responsible for establishing share-based incentive plans, which are suitable to the company and considered fair. Remuneration has become a very complex affair, and most members of the committee must therefore have experience in this field and have regular access to the advice of external remuneration consultants independent from executive management, with whom they must not have business relations that could give rise to conflicts of interest.

To avoid any conflicts of interest, the remuneration committee should consist entirely of non-executive directors who are also in principle independent.

In Switzerland, since the entry into force of the Minder initiative, the principles governing the tasks and powers of the remuneration committee must be included in the articles of association and therefore be approved by the general meeting. In addition, the members of the remuneration committee are elected annually by the general meeting.

### Sustainability committee

The task of the sustainability committee is to participate in the development of the company's sustainability strategy, the



policies for its implementation and the monitoring of this implementation. It is important that the sustainability strategy is an integral part of the company's strategy and that it is decided at the highest level of the company.

It is essential that the sustainability strategy covers the material issues of the company and defines key performance indicators and targets to be achieved in the short, medium and long term. In view of the climate emergency, climate change should be an integral part of any sustainability strategy. It is essential that companies communicate clearly and transparently about their sustainability strategy and its implementation.

In view of the challenges of sustainability for companies and their stakeholders, the sustainability committee should include at least one member with specific expertise in the field of sustainability.

### 3.8 SEPARATE OFFICES OF CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER (CEO)

Chairing a board of directors and running a company are two very important but distinct tasks. The separation of the offices of Chairman of the board and Chief Executive Officer is designed to ensure a balance of power within the company. It reinforces the board's ability to make independent decisions and to monitor the conduct of business by executive management.

The combination of the functions of Chairman of the board and CEO varies widely from country to country. For example, in the United States it is still common

(although increasingly called into question) for the same person to combine the positions. In the United Kingdom and in Switzerland, in particular in large corporations, the two offices are generally separate.

Should the board nevertheless opt for the combination of functions, it must provide a detailed and substantial justification for this situation, which should be considered temporary.

When there is combination of functions, the board must take steps to offset such concentration of power. In particular, the Chairman/CEO must not be a member of any key committee.

Furthermore, in case of combination of functions, the board should also appoint a "senior independent board member", or "lead director", with the following tasks:

- Put in place a structure that promotes an active role for independent directors. To that end, he has to co-ordinate the activities of the independent board members, ensure that the opinion of each member is taken into consideration and organise working sessions of non-executive directors exclusively.
- Make himself available to independent board members to discuss matters that were not adequately dealt with by the board and make sure that independent directors receive the information they need to perform their duties.
- Convene the board, whenever required, in the absence of the Chairman/CEO, in particular for a periodic assessment of the latter's performance.
- Collaborate with the Chairman of the board in drafting the agenda for board meetings.



- Facilitate relations with investors.
- Sit on key board committees and, in principle, chair the nomination and remuneration committee.

The corporate governance section of the annual report should include a brief description of the role and duties of the lead director.

### 3.9 INFORMATION ON NOMINEES PROPOSED FOR ELECTION TO THE BOARD OF DIRECTORS

One of the most important shareholder rights is to elect the members of the board. In order to be able to vote in an informed manner on each nominee, shareholders must receive information concerning nominees well before the annual general meeting. In particular, they should be informed of each nominee's identity, nationality, age, education and training, recent professional experience, length of tenure on the board, and, most importantly, any executive or non-executive positions held in other companies or organisations.

For new nominees, the company should indicate the particular reasons that led to their nomination (competencies, in-depth knowledge of the company industry or region, business connections, etc.).

Before re-electing directors, the shareholders must have all the relevant information to assess each member's contribution to the success of the board, as well as his/her rate of attendance of board meetings. To that end, the company should indicate, in its annual report, the number of board and committee meetings each director has attended. Nominees who were absent

too often, without due justification, should not be re-elected.

### 3.10 BOARD'S ELECTION MODALITIES

Board members must be elected individually. A grouped vote is counterproductive as it can lead shareholders to oppose all the nominees, in some cases the board as a whole, when they have objections to one or more directors. This could destabilise the company.

Due to pressure from the authorities, codes of best practice and shareholders, (re)elections of directors of listed companies are carried out individually in several countries. However, when companies proceed to group elections, as a sign of protest against the continuation of a bad practice, Ethos advocates a negative vote when the (re)election of one or more directors is deemed prejudicial to the interests of the company and its shareholders. Since 2014, in Switzerland, the Minder ordinance (the Swiss Code of Obligations since 1 January 2023), obliges Swiss listed companies to elect annually and individually the members of the board of directors, as well as to elect annually the chairman of the board by the general meeting.

All nominees should in principle be elected by the shareholders. Notable exceptions to the rule are Austria, Germany, France, Norway and Sweden. In Austria, Germany, Norway and Sweden, employee representatives are elected directly by the employees or their unions. In France, employee representatives are chosen by the employees. The representatives of employee-shareholders are first designated



by the employee-shareholders or by the supervisory boards of employee-shareholder funds. Afterwards the shareholders are required to vote, choosing from the proposed nominees who will finally sit on the board.

In the case of companies that have a supervisory board as well as a management board, the shareholders elect either the members of the supervisory board, who then nominate the members of the management board (Germany, France, the Netherlands), or the members of both the supervisory and at times the management board (Netherlands, under the structured regime).

### 3.11 CHARACTERISTICS OF DIRECTORSHIPS

#### Term

Each member of the board of directors is accountable to the shareholders and must therefore make himself available regularly for re-election at the annual general meeting. Annual elections allow continuous assessment of directors' performance and increased accountability to shareholders. In several countries, however, especially in continental Europe (France, the Netherlands, Germany and Spain), directors' mandates are of three years or more. In such cases, staggering the directors' terms ensures that part of the board is re-elected each year thereby avoiding that the entire board be re-elected simultaneously. In Switzerland, since 2014 the Minder ordinance (the Code of Obligations since 1 January 2023), requires the annual and individual election of directors.

The board must be regularly renewed in order to ensure a constant flow of new ideas and maintain a critical spirit. This is

particularly relevant in the case of independent directors. Ethos considers, as do several codes of best practice, that a director who has sat on the board for over twelve years can no longer be deemed independent. During such a long period, he will have participated in many projects and decisions that could compromise his objectivity and critical thinking. If he remains on the board, he must be considered an affiliated director, which does not prevent him from sitting on the board if the board independence is sufficient.

#### Number of mandates and availability

A director must have sufficient time to devote to his duties, and this is particularly relevant in a situation of crisis. In Switzerland, for example the Code of Obligations requires that Swiss listed companies fix in their articles of association the maximum number of mandates that members of the board and members of the executive management can hold.

In other countries, some codes of best practice in corporate governance set a maximum number of mandates. In the United States, for example, the Council of Institutional Investors (a non-profit association of public, union and corporate pension funds, including an increasing number of non US investors) considers that a full time executive cannot hold more than two outside directorships. The CEO should not hold more than one outside directorship. And a non-executive director without a full time executive position should hold no more than five mandates listed companies.

In the United Kingdom, the UK Corporate Governance Code stipulates that a full-time executive director of a FTSE 100 company



should neither be Chairman of the board of another FTSE 100 company, nor sit on the board of more than one other FTSE 100 company.

In France, a director may hold no more than five directorships in public companies on French soil. In Germany, the code of best practice in corporate governance restricts company executives to five supervisory board positions.

In Germany, the corporate governance code limits the number of external mandates to three listed companies for persons with executive functions.

In the Netherlands, the code of best practice limits to two the number of directorships for executive directors (excluding the chairmanship). For non-executive directors without a full time executive position the aggregate number of mandates should not exceed five, with chairmanships counting double.

When codes of best practice do not include limits, Ethos considers that a director with executive functions (or a full time position) should not, in principle, hold more than one mandate outside his company. For non-executive directors, the total number of mandates should be 5. This limit also depends on his chairmanships, as well as his participation in key board committees.

A director's availability can also be assessed by his attendance of board meetings. A director who, without good reason, has failed in one year to attend at least 75% of the meetings of the board or of the committees on which he serves should not be proposed for re-election.

### Age limit and maximum term of office

Certain companies, especially in continental Europe, to set a statutory age limit of 70 to 72 years beyond which a director must retire from the board. In North America, however, such practice might contravene anti-discrimination laws. In cases where no age limit exists, a director's nomination and re-appointment must be examined in the light of the board's explanations, his competencies, tenure, the length of the incoming term and, above all, the overall composition of the board of directors.

In principle, Ethos considers that a director should not be proposed for re-election when he reaches the age of 75. Also, a nominee should be less than 70 years old on first appointment.

Some companies also set a statutory limit to the number of successive terms a director can serve. The aim, obviously, is to renew the board regularly, and such limits can therefore be considered to promote fresh input and new competencies. Ethos set a 16-year mandate limit in its voting guidelines to ensure board refreshment is satisfactory.



## 4. Audit Firm

### 4.1 FAIRNESS OF THE ACCOUNTS

One of the fundamental responsibilities of the board of directors is to provide a “true and fair view” of the company’s financial situation and perspectives by ensuring the integrity of the accounts and any financial information disclosed by the company. To that end, the board must set up an internal and an external monitoring system. It must guarantee the quality, transparency and continuity of financial statements in order to provide the shareholders with a realistic view of the company’s financial situation.

The board of directors must therefore appoint an independent external auditing company to provide a neutral and objective auditing of the company’s annual accounts and financial statements and to confirm that its income allocation complies with the relevant legal requirements.

### 4.2 APPOINTMENT OF THE EXTERNAL AUDIT FIRM

Given the audit’s importance to the shareholders, in most countries the annual general meeting is called on to ratify the external audit firm appointed by the board, usually on the recommendation of the audit committee.

The board of directors often treats the approval of the external auditors as a matter of routine. However, it is of crucial interest to the shareholders to ascertain that the external auditor is entirely independent of the company to be audited, so that the fundamental principle of an objective

judgment is respected. In order to protect their rights, shareholders should only approve the board’s proposal after taking into account the criteria for independence required by the codes of best practice for external auditing.

### 4.3 INDEPENDENCE OF THE EXTERNAL AUDIT FIRM

#### General considerations

The auditors must be independent if they are to be credible in the eyes of investors. What is more, they must be independent not only in fact, but also in appearance, meaning their attitude must be such that no one can question their objectivity.

Codes of best practice in corporate governance require that the external audit firm be independent of the company’s board of directors, management and any major shareholder or group of shareholders. The principle of independence applies to the external audit firm’s board of directors, its executives and any employee directly involved in the auditing of the accounts.

The independence of the external auditor is a legal requirement in several countries, including Switzerland. The relevant Swiss legislation defines independence as “freedom from instructions, freedom of judgment and independence in decision”. The audit committee must scrupulously and systematically take these concepts into account when considering whether to appoint or re-appoint the external audit firm.



The independence of the audit firm can be compromised when there are personal or professional ties between the audit firm and the company to be audited. This is also the case for small audit firms when the fees received from a single client constitute a substantial proportion of their turnover. In order to ensure the external auditors' independence, international audit standards stipulate that fees paid by a single company to its external auditors should not exceed 10% of the audit company's total turnover.

It is the role of the audit committee to ensure that the auditor's independence is not compromised for any of the above-mentioned reasons, taking into account the auditors' professional standards and the generally accepted rules of best practice.

The regular rotation of the persons in charge of the audit mandate also contributes to ensuring the independence of the external auditor. For example, EXPERTsuisse and the new European regulation recommend that the company's lead auditor, who signs the audit of the accounts, be replaced at least every seven years, whereas the Sarbanes-Oxley Act in the United States stipulates a change every five years.

### Limits on non-audit services

Given the importance of the principle of independence, it is now generally acknowledged that the external auditor cannot perform, for the companies whose accounts it audits, a number of services that could impair its independence. The Sarbanes-Oxley Act (which was introduced in July 2002 and applies to all companies listed in the United States and to their auditors) groups such services into nine categories of tasks that are not compatible

with the role of external auditor: bookkeeping, the establishment and development of financial information systems, valuation or appraisal activities, internal audits, legal advice and other forms of non-audit expert advice, portfolio management and certain human resources management services.

In April 2014, twelve years after the introduction of the Sarbanes-Oxley Act in the United States, the European Union adopted a new directive and new regulation concerning the audit of accounts of public-interest entities. Public-interest entities include European companies listed on a European stock exchange, as well as banks, insurance companies and other entities with significant public importance. The new directive and regulation is applicable since June 2016. The new regulatory framework prohibits auditors from providing certain services to the audited companies. In particular, the services prohibited by the Sarbanes-Oxley Act will also be prohibited in the European Union. The new European regulation goes even further than the Sarbanes-Oxley Act by prohibiting, for example, certain tax services as well as the conceptualisation and implementation of procedures of internal control or the risk management in connection with the preparation or the control of financial information.

There are, however, a large number of services, other than those prohibited by the different regulations that external auditors provide for clients whose accounts they also audit. Although these services are authorised, they can seriously compromise the external auditor's independence because of the received amount of fees, which sometimes far exceeds the audit fees.



Thus, in order to maintain the external auditor's independence, the new European regulatory framework limits the amount of fees received for non-audit services to 70% of the average audit fees from the last three years.

Generally, according to several corporate governance specialists, an audit firm cannot be considered independent if the fees received for non-audit services exceed a certain threshold in comparison to the fees received for the audit of the company's accounts. This threshold is stipulated in the voting guidelines of the investors or consultants. Ethos considers that the audit firm should not be re-elected when the fees received for non-audit services exceed the fees for audit services, or when for three consecutive years, the cumulative non-audit fees exceed 50% of the aggregate audit fees. An analysis of the fees paid out over more than one year can reveal a clear trend in terms of the auditor's fees and therefore enable the shareholders to evaluate auditor's independence vis-à-vis the company. The audit committee should inform the shareholders why the external auditors provide non-audit services for an amount exceeding the limits stipulated above.

In order to ensure the external auditor's independence, each company's audit committee must draw up a formal policy on authorised non-audit services and the corresponding fees. This policy must be disclosed to the shareholders.

To enable investors to assess the risks to the independence of audit firm, it is essential to analyse the breakdown between fees received for auditing services and fees for other services, in particular consultancy services.

The way fees paid to the audit firm are presented varies widely from one country to another. In some countries, companies present the fees paid to the auditor in clearly distinct categories, indicating the corresponding amounts, while in others there is no obligation to provide that amount of detail. In Switzerland, Directive on Corporate Governance of the SIX Swiss Exchange requires companies to publish separately the total fees invoiced by the auditor for the audit in the current financial year from the total fees invoiced for other services, with a mention of the nature of the services other than the audit. Ethos considers that the total amount for other services be broken down into its main components, such as tax advice, legal advice and transaction consulting including due diligence. General and vague formulations such as "various services" are to be avoided as they are boilerplate.

Given the variety of requirements regarding the disclosure of fees paid to the external auditor, international comparisons are not always easy. Therefore the investors base their assessment of the external auditor's independence on the amount of detail provided and on the guidelines each investor follows.

### Rotation of the audit firm

Finally, in order to raise the independence of the audit firms by reducing excessive familiarity of the external auditor with the audited company due to long mandates, the new directive of the European Union introduced the obligation to rotate the audit firm for public-interest entities, in particular listed companies. In fact, audit terms may no longer last more than ten years (twenty years if a tender is issued after ten years and



twenty-four years at most if several audit firms are hired and present a joint audit report). These provisions are applicable for new audit mandates as of 2017 with transitional provisions for running mandates

In Switzerland, the current legislation does not include any provision on the rotation of the audit firm. The preliminary draft of the revision of the Swiss Code of Obligations does not foresee any provisions concerning the independence of the audit firm and no revision of the Auditor Oversight Act, which also includes the independence criteria for audit firms, is planned at this time.

Ethos considers that the decisions of the European Union have set up a practice that Switzerland cannot ignore for long. Therefore, since 2017, Ethos applies a maximum 20-year term for audit firms.

## 4.4 AUDIT REPORT

### Materiality threshold and audit scope

The primary objective of an audit of financial statements is to enable the auditor to express an opinion on the fairness of the information presented. In order to achieve this objective, the auditor must seek reasonable assurance that the financial statements are free from material misstatement. Such misstatements are considered material if, individually or in the aggregate, they could influence economic decisions made on the basis of the financial statements. In order to determine the extent and nature of the procedures to be performed, the auditor is required to calculate a materiality threshold, which is defined as the threshold above which misstatements are considered material. Thus,

if the auditor believes that the company's accounts present a high risk of misstatement (resulting from error or fraud), he will set a lower materiality level, which will have the effect of increasing the scope of the audit in order to cover a greater part of the company's activities. The disclosure of the materiality level and the scope of activities covered by the audit procedures is important information for a better assessment of the reliability of the financial statements presented.

### Key audit matters

The vast majority of readers are only interested in the audit report when the auditor expresses reservations or, in certain exceptional cases, refuses to endorse the accounts. This is because the standardised form of the audit reports often does not provide sufficient transparency on the major risks facing the company. However, these reports should help shareholders and other stakeholders to assess the control procedures put in place by the auditor and the company's management to mitigate these risks. To this end, International Standards on Auditing (ISAs) have introduced, as of 2016, the requirement to include in the auditor's report key audit matters that are considered relevant. In parallel, many countries have revised their national auditing standards to introduce these transparency requirements. This was the case for the Swiss auditing standards (NAS) in 2018 and for the US auditing standards (US GAAS), which introduced equivalent requirements in 2017. Key audit matters are significant items that are given special consideration during audit procedures. The significance of the item may be due to its complexity, its importance for the assessment of the economic situation of



the company or the discretion of the management as to its valuation. According to the revised standards, the auditor's report must explain the specific audit procedure applied with reference to additional information in the company's financial statements. However, because the decision to include a risk in the key audit matters is subjective to the auditor, some reports still fail to mention material risks.

The lack of transparency about the specific procedures the auditor has in place regarding these risks prevents the reader of the financial statements from assessing the reliability of the figures presented by the company.

### Climate risk assessment

Climate change risks are still very rarely included in the key audit matters. However, given the impact of climate change on companies and the tightening of legislation on greenhouse gas emissions, climate change is a risk for most companies.

On the one hand, companies operating in a climate-sensitive sector will be greatly impacted by the energy transition (transition risk), and on the other hand, companies with high emissions risk being exposed to higher expenses and investments to adapt their activities to a low-carbon economy. Therefore, it is essential for these companies to consider climate risk in their financial statements and the auditor must conduct specific procedures to evaluate the assumptions made by the companies.

In order to achieve a sufficient level of transparency in this respect, especially in companies with high CO<sub>2</sub> emissions, the audit report should include confirmation that the valuation of assets and provisions made

by the company take into account the climate risk and the company's reduction targets in accordance with the applicable accounting standards.

In addition, the auditor should inform the shareholders about the adequacy of the assumptions made by the company to meet its climate objectives. Finally, when the auditor believes that the climate assumptions used in the financial statements do not give a true and fair view of the company's economic situation, the auditor should qualify the audit opinion in order to alert the reader of the financial statements.



# 5. Board and Executive Remuneration

## 5.1 REMUNERATION ISSUES

In order to attract, retain and motivate the best staff, a company has to establish a remuneration system that is attractive compared to its competitors. Generally speaking, such a pay system should be designed so as to align the participants' interests with those of the shareholders, contributing to long-term value creation.

The design of the remuneration system is very important, in particular for the following three reasons: First, a remuneration system that yields excessive pay-outs is an important cost that is borne by the company's shareholders. Secondly, the remuneration system can strongly influence the attitude of managers toward risk taking, thereby impacting the strategic orientation of a company. Finally, an inappropriate remuneration system constitutes an important reputational risk that can compromise investors' trust and the motivation of employees.

With regard to executive remuneration, a company should establish guidelines pertaining to:

- The transparency of the remuneration system.
- The structure and payouts of the remuneration system.
- The competencies with regard to setting executive remuneration.

## 5.2 TRANSPARENCY OF THE REMUNERATION SYSTEM

### 5.2.1 GENERAL FRAMEWORK

Transparency of the remuneration system is necessary to ensure the shareholders' trust. The system must be described in clear and exhaustive detail, so that the shareholders can assess its benefits in terms of its costs. However, companies should avoid diluting the essential information about the remuneration system in overly detailed descriptions.

To encourage companies to be transparent with regard to the remuneration system, most codes of best practice have introduced specific provisions. However, given that self-regulation rarely works in the field of remuneration, it became necessary to make the publication of certain information about the remuneration system mandatory. Hence, depending on the country, the shareholders should receive information in a special section of the annual report or in the agenda of the annual general meeting.

Generally speaking, the remuneration report should include the following:

- a. A detailed description of the principles and mechanisms of the remuneration system and of each of its components (basic salary, annual bonus, long-term incentive plans, benefits in kind, pension fund contributions).
- b. The global amount of the remuneration and the value of its various components for each director and member of executive management. Options and shares



- must be valued at their market value at grant date. In order to facilitate understanding, a tabular presentation of the amounts under separate columns corresponding to the different types of awards granted during the year under review is indispensable as a complement to the narrative section. The total value of the remuneration should also be featured in a separate column.
- c. A separate and detailed description of each incentive plan under which stock options, shares or cash are granted, with the main characteristics thereof in each case (eligibility, performance criteria, grant date, exact grant price, vesting and retention period, upward potential and matching grants if any) and the method of financing (by issuing new shares or by using repurchased shares).
  - d. The amounts paid out under the variable remuneration, such as the annual bonus, as well as the realised remuneration from long term incentive plans. In order to facilitate understanding, a presentation in the form of a table with separate columns for the amounts corresponding to the different payments during the year under review and their sum total is desirable. This information is important for putting into relationship the remuneration at grant with the realised remuneration and therefore to confirm the good functioning of the system and the connection between pay and performance.
  - e. A summary of senior executive retirement plans. For transparency reasons, the amounts involved should be disclosed or easily computable.
  - f. A description of senior executive contracts, including the conditions of appointment and departure and of any non-compete clauses. When provision is made for special compensation in case of change of control, those provisions should also be disclosed in the report. It is indispensable to disclose separately the amounts effectively paid out during the period under review.

## 5.2.2 THE SITUATION IN SWITZERLAND

In Switzerland, listed companies must provide the following information in a separate remuneration report (previously in the notes to the accounts) that must be audited by the external auditor:

- The individual remuneration of members of the board of directors.
- The aggregate remuneration of the members of the executive management.
- The remuneration of the highest paid executive.

In the notes to the accounts, that must also be audited by the external auditor, the number of shares and options held by each member of the board and the executive management must be published.

Also, all companies subject to IFRS standards must publish, in the notes to the accounts, the parameters used to calculate the fair value of stock options (share price at grant date, exercise price, volatility, risk-free



interest rate, expected life and dividend yield).

In addition, the SIX Swiss Exchange, in the comment on the Directive on Corporate Governance (DCG), requires a detailed list of all the indications that companies must provide regarding the principles and components of board and executive remuneration, on the procedures for setting pay and the competencies in this matter.

## 5.3 STRUCTURE OF THE REMUNERATION SYSTEM

There are significant differences in the remuneration structure of the members of the board of directors and executive management members. When analysing executive pay structure, a distinction must therefore be made between the two.

Regarding employees, the difference between the highest and lowest remuneration should not only be limited but also duly justified. In addition, the same reasoning should apply to the ratio between the remuneration of the CEO and the remuneration of the persons on the following hierarchical levels.

Executive pay should also not systematically rise disproportionately to the pay of other employees, so as not to foster a feeling of injustice within the company that could have a negative impact on employee motivation.

### 5.3.1 MEMBERS OF THE EXECUTIVE MANAGEMENT

For Ethos, the remuneration structure of executive management should take into account the following principles:

- The maximum amount of each component of the pay package must be fixed, thereby setting a cap on total annual pay. The maximum amount should be determined bearing in mind the company's size and complexity as well as the practice of the peer group.
- The variable component should depend on clearly defined and sufficiently challenging performance criteria, so as to align the interests of executives with those of the shareholders.
- The on-target variable component, in principle should not be more than 1.5 times the base salary for the CEO. For other senior managers, the on-target variable component should not be more than 100% of the base salary.
- The maximum variable remuneration (for overachievement of objectives) should not in principle be more than twice the on-target variable component.

Payments in excess of the values stipulated above could be accepted under exceptional circumstances when the majority of the variable remuneration depends on the achievement of relative performance targets measured over a sufficiently long period.

The components of remuneration are as follows:

#### Base salary

The base salary must take account of the skills and experience of the persons concerned and of the base salaries paid by other listed companies of similar size, structure and complexity that are looking to



hire the same profiles. In principle, it should not be set at a level exceeding the median of the company's peer group to avoid an upward ratchet of remuneration levels. Base salary is paid in cash and any increases must be justified.

### Annual bonus

The annual bonus is the short-term variable component of remuneration. It is intended to reward performance achieved during the year under review. It should not be awarded automatically, nor should it be considered a fixed form of remuneration, as some companies would have the shareholders believe. The annual bonus is not taken into account to calculate pension benefits and should not be automatically included when calculating severance pay.

Generally speaking, the amount of annual bonus granted depends on the degree of achievement of performance criteria. The criteria must be in line with the company's strategy and established at the beginning of the period under review. The criteria must also be disclosed in the remuneration report or in the annual report. In order to avoid publication of commercially sensitive information, the company can disclose the specific targets for the bonus *ex post*.

Regarding top executives (with the exception of the CEO whose remuneration should only depend on the group's results), performance criteria based on the company's results can be combined with criteria relating to individual performance based on the success of the division or functions exercised by the beneficiary. Furthermore, in addition to these purely financial criteria, key performance indicators (clearly defined and measured) should also be taken into consideration

reflecting the company's social and environmental performance, such as safety in the workplace, job security, absenteeism, customer satisfaction, reduced greenhouse gas emissions and waste management

When it comes to measuring a company's performance, the use of general economic indicators such as stock market indexes should be avoided; such indicators reflect market trends and not necessarily individual company performance.

When part of the bonus is paid in the form of shares or stock options, it takes on a long-term dimension. In principle, the shares must be blocked for several years. When additional grants are to be made at the end of the blocking period, for example if a matching share is obtained for a certain number of shares blocked for three years, the attainment of additional performance targets should be required – blocking the shares is not by itself sufficient justification for additional grants.

The amount of the maximum individual bonus should be limited as a percentage of the base salary, as should any exceptional grants.

To avoid rewarding short-term performance, achieved through excessive risk taking, part of the annual bonus should be deferred and subject to clawback provisions allowing recovery in case of bad financial results in subsequent years, or fraudulent behaviour leading to a restatement of accounts.

### Long-term equity-based incentive plans

In principle, long-term incentive plans are based on the award of shares or stock options. They can also grant the equivalent of gains on shares and stock options in cash. In



that case, however, the beneficiaries never receive equity, which distorts the plan's initial purpose to enhance participation in the company's capital.

The plans are forward looking, since their aim is to incentivise the participant to create long-term value, thereby aligning their interests with those of the shareholders. Unlike bonuses, they should therefore be structured in such a way as to reward future rather than past performance.

Companies should provide a detailed description of each plan in the remuneration section of the annual report or, in the agenda of the annual general meeting. The description should comprise eligibility, reserved capital, performance criteria, vesting, exercise and retention conditions, any additional grants and the conditions for obtaining them, and target and maximum individual grants. The plans should not be modified in any significant way without prior shareholder approval.

Given the substantial earnings to be made by the participants, and in order to align the interests of the various stakeholders, the final release of awards should be contingent on meeting stringent performance targets tested over a sufficiently long period (minimum three years). Indeed, the exercise of options and the final release of shares should be conditional on the achievement of performance targets. In particular, a rise in the share price above the strike price is not a sufficient condition. Such a rise does not necessarily reflect the company's performance but could be simply due to a general rise in share prices or to the effect of an announcement.

From the perspective of long-term value creation, it is important that the performance objectives are aligned with the company's

strategy. Additionally, performance must be tested both in absolute and relative terms (compared to a peer group). The peer group must be relevant and disclosed in the remuneration report.

In order to align interests, no awards should be released at the end of the performance period, if the company performance is below the median of the peer group. In order to assess the link between company performance and remuneration paid, companies should, at the end of the performance period, publish the degree of achievement of objectives, as well as the number of shares released and their value.

Participation by the same person in more than one plan must be duly justified and subject to different performance criteria for each plan, in order to ensure that the person does not simply accumulate pay packages. In principle, Ethos considers that it is useless to increase the number of long-term plans as this adds complexity to the remuneration system without necessarily leading to a better alignment of interests.

To avoid excessive variable remuneration, grants should be capped globally (to a percentage of the company's capital) and individually (for example, as a percentage of the person's base salary).

All directors and members of the executive management should gradually build up a portfolio of the company's shares that should be kept for the entire period of their employment with the company, in order to ensure that their interests are aligned with those of the shareholders. If the participants receive large numbers of shares or stock options each year but ultimately own very few shares, this form of remuneration will no longer be an incentive to participate in the



company's capital but solely an additional form of remuneration.

### Pension contributions

Employer contributions to executive management pension schemes are a form of deferred income that has become increasingly important in recent years. The amounts involved can be substantial. These contributions are a form of disguised fixed remuneration, i.e. as unrelated to performance.

It is therefore very important for companies to be particularly transparent about pension fund contributions. They must indicate, individually for each of the persons concerned, the amounts granted during the year under review. In addition, it is considered best practice for the company to disclose annually the total current value of the pension benefits accruing to individuals under such plans.

### Employment contracts

Executive contracts also form part of the remuneration system. An annual review of such contracts by the remuneration committee ensures that they continue to be relevant and appropriate.

Best practice further expects that notice periods should be set at one year or less. It may be justified, however, on appointment to have an initial notice period of maximum two years to compensate for the risks involved in changing employment, but the subsequent contracts should provide for one year's notice (or less). There should be no automatic entitlement to bonus, and no provision should be made for special payments in case of change of control, so as not to encourage executives to sell the company just to receive substantial remuneration. The golden parachutes should

not be replaced by signing bonuses (golden hellos) without performance conditions.

In Switzerland, the Code of Obligations requires that executive contract length and notice periods do not exceed one year. The law also prohibits anticipated remuneration and severance payments. Signing bonuses and replacement payments are authorised if they are covered by the reserve foreseen in the articles of association for the remuneration of new members of the executive board or if they are approved by the general meeting. Non-compete clauses are also allowed and must be mentioned in the articles of association.

## 5.3.2 MEMBERS OF THE BOARD OF DIRECTORS

### Fees

The remuneration of non-executive directors must also be disclosed in the remuneration report. Although it is generally simpler than that of the executive management, it often includes a component paid in securities of the company, most often in shares.

In principle, non-executive directors should not receive variable remuneration as it can tie their interests with those of senior management. The board's and management's interests could lead to collusion and loss of the board's objectivity in performing its oversight and control duties. In addition, non-executive directors should not receive fees for consulting activities on a regular basis or in amounts that are too high in order not to compromise their independence.

Most codes of best practice recommend that non-executive interest in the company take the form of blocked shares. Stock options



must be prohibited as the speculative nature of stock options could prompt the board to take too great an interest in the short-term share price rather than in creating long-term value.

Non-executive directors should not be entitled to severance payments or, in principle, to pension benefits.

### Holding shares in the company

When non-executive directors own shares in the company they prove their attachment to the business, their interest in its long-term success and thus demonstrate that their interests are in line with those of the shareholders and the other stakeholders. According to the International Corporate Governance Network (ICGN) this is a basic principle. Companies should therefore require their directors gradually to build up a portfolio of shares that they will keep until they retire from the board. The conditions for this are to be presented in the remuneration report. In Switzerland, the Code of Obligations requires that each director's holdings be included in the remuneration report.

## 5.4 COMPETENCIES WITH REGARD TO REMUNERATION

Setting the remuneration system does not fall only to the board of directors but should be shared with the shareholders. The latter should not interfere in the day-to-day running of a business, which is the role of the board and of the executive management. However, given the cost and risks generated by an inappropriate remuneration system, shareholders in their capacity of company

owners should also have a say on executive pay.

### 5.4.1 THE BOARD OF DIRECTORS' COMPETENCIES

Given the complex nature of executive pay, it is best practice for the board of directors to appoint a remuneration committee to deal with remuneration matters. As a rule, it is this committee that proposes the fundamental principles and mechanisms of the remuneration policy to the board, which ultimately approves them. The same applies for share and stock option plans.

The remuneration committee should regularly review the remuneration policy as a whole and incentive plans in particular, so as to check that they continue to be relevant.

The fees of the remuneration committee members are set by all the other members of the board of directors, who must ensure that those fees are not aligned on the remuneration of the management, so that committee members remain independent and able to fulfil their duties objectively and in the shareholders' long-term interests.

In Switzerland, the Code of Obligations foresees the creation of a remuneration committee whose tasks and responsibilities must be written down in the articles of association and whose members are elected each year by the general meeting.

### 5.4.2 THE SHAREHOLDERS' COMPETENCIES

Several countries have introduced strict rules on the transparency of remuneration. As a result, more and better quality information is disclosed, unveiling pay packages that may appear excessive. Consequently, disclosure must go hand-in-hand with the shareholders'



right to have a say on the fundamental principles and mechanisms of executive remuneration in listed companies.

Various countries have gradually adopted rules giving the shareholders competence in matters of remuneration. They have done so either by including the relevant provisions in national codes of best practice or by incorporating them into domestic legislation or into listing rules of stock exchanges.

In the European Union, the Shareholder Rights Directive II (2017) reinforces national mechanisms by introducing new obligations for listed companies on remuneration. It establishes the "Say on Pay" principle by requesting an ex-ante vote on the remuneration policy (at least once every 4 years, advisory or binding) and an ex-post vote on the remuneration report (annual, advisory). The SRD II allows some flexibility in the implementation of those principles. The table below presents the different systems in place in the main markets concerning the rights of shareholders with regard to setting executive remuneration.

#### 5.4.3 THE SHAREHOLDERS OF SWISS COMPANIES' COMPETENCIES

Switzerland has been among the countries where shareholders have the most rights when it comes to setting the remuneration of management bodies. In fact, shareholders now have the non-transferable right to vote the overall amounts of remuneration not only for the board of directors, but also for the executive management and, where applicable, the advisory board.

Swiss-listed companies must submit the amounts of the remuneration of the management bodies to the vote of the

shareholders. The law includes three minimum requirements:

- Shareholders must vote annually on the remuneration.
- Shareholders must vote separately on the amounts granted to the board of directors, executive management, and the advisory board.
- The shareholders' vote is binding.

Additional provisions, in particular voting procedures, must be provided for in the articles of association.

#### Voting methods

The voting methods must be fixed in the articles of association. For the remuneration of the board of directors, the companies in principle propose a prospective vote on the fees. For the remuneration of the executive management, companies can offer:

- A single vote on the maximum total amount ;
- Separate votes for the fixed and variable amounts.

They can also choose between:

- Prospective vote (ex-ante) by requesting a maximum amount;
- Retrospective vote (ex-post) on the actual remuneration they wish to pay at the end of the period, when the achieved performance is known.

#### Separation of votes

Ethos believes that votes on fixed remuneration should be separated from votes on variable remuneration. Indeed, fixed remuneration is in principle known in advance while variable remuneration should



depend on past or future performance. Furthermore, Ethos considers that it would be preferable to separate the votes on short-term variable remuneration (annual bonus) from votes on long-term variable remuneration (participation plans generally in securities). When companies ask for a single amount for all of the variable remuneration, it is important that they explain how the amount is split between the short-term bonus and the long-term participation plans.

### Time of voting

For fixed remuneration, Ethos believes that a prospective vote is the best solution. It would indeed be difficult to justify that the members of the executive management must wait for the general assembly of the following year to be sure of receiving their fixed base salary for the past period.

For short-term variable remuneration (annual bonus), Ethos considers that it is preferable to provide for a retrospective vote on the amount effectively granted with relation to the performance achieved. Indeed, such a vote allows companies to be precise in their request instead of having to prospectively request a maximum envelope of a relatively high amount, while the amount actually paid is often much lower than the maximum requested amount. At the same time, a retrospective vote allows to avoid the risk for the shareholders of seeing the maximum amount being unduly distributed.

When a company nevertheless wishes to have the maximum amount for the bonus adopted prospectively, it is essential to have a very high level of transparency in terms of the remuneration system. In particular, it is necessary for shareholders to know the precise performance criteria. Unfortunately,

this is rarely the case since the precise goals to be achieved are information that companies consider competitively sensitive that they are not prepared to release in advance. In addition, the remuneration system described in the articles of association should specify the maximum multiple of the variable remuneration compared to the fixed salary.

With regard to long-term variable remuneration, the specific performance targets set are generally less sensitive from a competitive point of view and may be based on external conditions over which the company has no influence. Their publication therefore poses fewer problems for companies and the transparency could be sufficient for a prospective vote to be possible. It is necessary not to lose sight of the problem relating to the calculation of the amounts that the companies must request and which, for certain plans, may appear excessive, since they correspond to the maximum potential (theoretical) value that would be due if the beneficiaries exceeded all targets set at the start of the performance measurement period.



## Shareholder rights with regard to board and executive remuneration

|                      | Ex-ante vote on the remuneration system of the executive management | Ex-post vote on the remuneration report | Vote of the remuneration of the board of directors | Vote of the remuneration of executive management | Vote of share-based incentive plans |
|----------------------|---|---|--|--|-------------------------------------|
| <b>EUROPE</b>        |   |   |  |  |                                     |
| Austria              | advisory (6)  | advisory (1)                            | yes (3)  | -  | yes                                 |
| Belgium              | binding (6)   | advisory                                | yes  | -  | yes                                 |
| Denmark              | binding (6)   | advisory (1)                            | yes  | -  | -                                   |
| Finland              | advisory (6)  | advisory                                | yes  | -  | -                                   |
| France               | binding (6)   | binding                                 | yes (4)  | -  | yes                                 |
| Germany              | advisory (1) (6)  | advisory (2)                            | yes (3)  | -  | yes                                 |
| Italy                | binding (5)   | advisory                                | yes  | -  | yes                                 |
| Ireland              | binding (6)   | advisory                                | yes  | -  | yes                                 |
| Netherlands          | binding (6)   | advisory                                | yes  | -  | yes                                 |
| Norway               | binding (6)   | Advisory (2)                            | yes  | -  | yes (3)                             |
| Portugal             | binding (6)   | advisory                                | -  | -  | yes                                 |
| Spain                | binding (5)   | advisory                                | yes  | -  | yes                                 |
| Sweden               | binding (6)   | advisory                                | yes  | -  | yes (6)                             |
| Switzerland          | -   | -                                       | yes  | binding  | -                                   |
| UK                   | binding (5)   | advisory                                | -  | -  | yes                                 |
| <b>NORTH AMERICA</b> |   |   |  |  |                                     |
| Canada               | -   | advisory (7)                            | -  | -  | yes                                 |
| USA                  | -   | advisory (8)                            | -  | -  | yes                                 |
| <b>ASIA</b>          |   |   |  |  |                                     |
| Australia            | -   | advisory                                | yes (9)  | -  | yes (10)                            |
| Hong Kong            | -   | -                                       | yes  | -  | yes                                 |
| Japan                | -   | -                                       | yes (11)   | -  | yes (12)                            |
| N. Zealand           | -   | -                                       | yes  | -  | -                                   |
| Singapore            | -   | -                                       | yes (13)   | -  | -                                   |

(1) Starting in 2021. (2) As of 2022. (3) Binding, unless otherwise specified in the bylaws. (4) Binding. (5) Every 3 years. (6) Every 4 years. (7) The final allocation of shares must be approved by at least 90% of the votes represented. (8) Introduced voluntarily by some companies. (9) The frequency of the vote (1, 2 or 3 years) is put to a vote and approved by the general meeting. (10) Only in case of change. (11) Only in case of issue of shares within the framework of participation plans for members of the board of directors. (12) For "Kansayaku" companies. (13) Only in case of issue of shares under stock option plans. (14) Shareholders can vote on the total amount to be paid to directors.



## 6. Capital Structure and Shareholder Rights

### 6.1 SHARE CAPITAL

Decisions with regard to share capital are an essential feature of a company's governance. In fact, the share capital structure, which defines certain shareholder rights, including the right to vote, has a direct impact on the exercise of power and the possibilities of takeover.

In most countries, shares are either of the bearer or the registered type. A bearer share enables the shareholder to remain anonymous whereas in the case of a registered share, the shareholder has to register on the corporate share register, in order to be able to exercise the voting rights pertaining to the shares. Registered shares therefore allow the company to know its shareholders. Companies can also issue investment certificates, participation certificates and dividend-right certificates, which confer only pecuniary rights and therefore do not entitle the holder to vote.

Most codes of best practice require that voting rights be exercised on a pro rata basis to the investment in the capital so that proportional participation by all shareholders in the decision-making process is ensured. Hence, the most appropriate capital structure consists of a unique class of shares.

All countries require that a company's capital be set down in its articles of association. However, the system used to establish or modify the share capital may vary according to the relevant national legislation.

**Establishment in the articles of association of the maximum capital the company may issue**

In the United States, the United Kingdom, the Netherlands and Japan, for example, the company's articles of association establish a maximum number of shares that the company may issue. The number of shares must be approved by the annual general meeting. The amount of capital actually issued by the company may be below the authorised amount.

**Establishment in the articles of association of the issued capital**

In other countries, such as Switzerland, France, Germany, Italy, Spain, Sweden, and Finland, the company's articles of association indicate the amount of issued capital.



## 6.2 CAPITAL INCREASE

### 6.2.1 GENERAL FRAMEWORK AND PRE-EMPTIVE RIGHTS

When the amount of capital specified in the articles of association is no longer sufficient for the company's needs, the company is compelled to increase it. Authorisation to increase capital may be requested for general or specific purposes.

Given that capital increases entail a dilution of the shareholders' pecuniary rights (right to a dividend) and voting rights, in many countries, including Switzerland, the law offers compensation by granting pre-emptive rights. In other countries, such as the United States, pre-emptive rights are the exception.

Thus, the impact of the capital increase on the shareholders' rights will depend on whether or not pre-emptive rights are maintained, limited or even waived. As a result, investor decisions regarding capital increases take account of the reason for the increase and whether or not pre-emptive rights are granted.

Pre-emptive rights enable shareholders to acquire the newly issued shares at a rate that is proportional to their previous holdings. A shareholder who exercises his pre-emptive rights therefore maintains his stake in the capital and suffers no dilution of his profits or voting rights. When pre-emptive rights are endorsed by company law, they can be waived following approval by the shareholders' general meeting under certain conditions.

However, even when capital increases are accompanied by pre-emptive rights, the increase should not be too substantial. The limits in place are designed to protect the shareholders, either from excessive financial

pressure for those wishing to maintain their stakes in the company, or from a serious dilution of their rights if they fail to subscribe.

Sometimes, depending on the purpose of the capital increase, companies have to waive their shareholders' pre-emptive rights. Such increases can serve specific purposes, such as the conversion of options granted to employees or the financing of a particular project. Capital increases without pre-emptive rights must therefore remain modest, and the shareholders' decisions depend on their appraisal of the goals presented by the company.

### 6.2.2 CAPITAL INCREASE FOR GENERAL FINANCING PURPOSES

An increase in capital for general purposes may be requested by the board of directors at an annual general meeting in anticipation of general needs of capital unknown at the moment of request. Following approval, the company may then make use of the capital as circumstances require. This enables it to react quickly to opportunities that may suddenly appear. In such cases, the deadline for calling an extraordinary general meeting could hinder the realisation of transactions that would be beneficial for the company.

When requests for an increase in capital for general purposes are not regulated by the law or by generally accepted best practice standards, institutional investors and consultants each set their own limits. Hence, the codes of best practice provide for larger authorisations to issue capital when shareholders' pre-emptive rights are guaranteed.



### 6.2.3 CAPITAL INCREASE FOR SPECIFIC PURPOSES

An increase in capital for specific purposes may be required to finance, for example, a stake in or acquisition of a company or to issue shares following the exercise of employee stock options. In such cases, the capital issued must be used exclusively for the purpose requested.

Requests for an increase in capital for specific purposes must be analysed by applying the same rules as for increases in capital for general purposes; the appropriateness of the reason for the increase (acquisition, employee incentive plans, etc.) must also be analysed. The analysis should consider whether the plan presents a value for the company and serves the long-term interests of the shareholders and other stakeholders. Depending on the purpose of the increase, it may be possible to accept a more substantial dilution of rights than in the case of an increase in capital for general purposes without pre-emptive rights. Such increases must be authorised on a case-by-case basis.

### 6.2.4 THE SWISS CASE

In Switzerland, in addition to their ordinary capital, companies may have a capital fluctuation margin and conditional capital. Thus, at a general meeting, companies may request to include in their articles of association authorisations to increase ordinary capital, to create or modify a capital fluctuation margin, as well as to create or modify conditional capital. When analysing such requests, shareholders should take into account the potential dilution resulting from each authorisation separately and from all authorisations globally. Ethos considers that the aggregate authority to raise capital

without pre-emptive rights for general financing purposes should not exceed 20% of issued capital.

As of 1 January 2023, the capital fluctuation margin system replaced the authorised capital under Swiss law. However, during a transitional period, the authorised capital will remain valid until its expiration, but it will not be able to co-exist with the capital fluctuation margin. Therefore, if a company wishes to introduce a capital fluctuation margin in its articles of association, it will have to replace any existing authorised capital. This transitional period is limited to two years, which corresponds to the maximum duration of an authorised capital under Swiss law.

#### Ordinary capital

A company's ordinary capital is set in its articles of association. Any increases in the ordinary capital require the authorisation of the annual general meeting, which allows the board to proceed to a one-time increase of capital by a fixed amount. The increase will have to be executed in the six months following the decision and the amount of the new capital must be set out in the articles of association.

In order to avoid dilution of the shareholders' pecuniary and voting rights, ordinary capital increases are in principle accompanied by pre-emptive rights for existing shareholders, unless the increase is to be used for example to acquire another company or for a merger by exchange of shares.

In the case of requests for an ordinary capital increase, the decision of the shareholders depends on the objective pursued by the company and on whether or not the pre-emptive rights are maintained. In the case of



requests for general financing purposes, Ethos accepts in principle a capital increase of 33.3% of the share capital at the time of authorisation if the pre-emptive rights are guaranteed and 10% if they are limited or waived, unless the purpose, duly justified, justifies a higher amount.

### The capital fluctuation margin

In order not to have to convene an extraordinary general meeting every time it needs to increase the company's capital, the board of directors can ask the annual general meeting for the right to create a capital fluctuation margin (Art. 6513s CO). The capital fluctuation margin may be used for general financing purposes or for specific reasons, such as to purchase a company or a stake in a company.

By approving the creation of a capital fluctuation margin, the general meeting gives the board of directors the right to carry out, on its own initiative, successive capital increases or decreases up to the authorised amount, for a maximum period of five years. The upper limit may not exceed one and a half times the share capital entered in the commercial register, and the lower limit is set at half the share capital entered in the commercial register (Art. 653 ff., para. 2 CO). The articles of association may provide that the fluctuation margin only allows an increase or decrease of the capital (Art. 653s para. 3 CO).

In the case of an application for a capital fluctuation margin, the procedure for increasing the capital is similar to that of the ordinary capital increase, except that the board has a period of five years from the approval to carry out the increase, either en bloc or in stages. In contrast to the ordinary

capital increase, in the case of the capital fluctuation margin, the board does not have the power of execution but has the authority to execute. The board will decide on the timing and the precise amount of the capital increase in function of the company's financing needs. These authorisations give the board the flexibility to quickly seize unforeseen opportunities.

As in the case of the ordinary increase, the pre-emptive rights of existing shareholders are in principle guaranteed. However, should the company need to use the authorised capital to purchase another company or a stake in a company, the pre-emptive rights may be limited or waived (CO Art. 652b, para. 2).

Each time the board makes a capital increase within the capital fluctuation margin, it must amend the articles of association to set the new ordinary share capital. When the five years are over, it must delete the provision on the capital fluctuation margin from the articles of association. If the company needs a new capital fluctuation margin, the board must submit a new request to the annual general meeting.

For the "increase" part of the capital fluctuation margin, the shareholders' decisions depend on the purpose of the increase and on whether or not the pre-emptive rights are maintained. When this request does not contain specific objectives, Ethos accepts an authorisation of maximum 20% of the share capital issued at the time of the authorisation (legal limit) if the pre-emptive rights are guaranteed and 10% if they are limited or withdrawn. However, shareholders should be aware of the potential total dilution that could result from the authorisations granted as a whole (share



capital, capital fluctuation margin and conditional capital).

### Conditional capital

Swiss law also authorises companies to have what is known as conditional capital (CO Art. 653), which serves exclusively to convert:

- Convertible bonds held by bond-holders;
- Options held by company employees or others.

According to Swiss law, the amount of the conditional capital must be approved by the annual general meeting and may not exceed 50% of the existing share capital (CO Art. 653a).

The company's ordinary share capital gradually increases as the bondholders convert their bonds and the employees exercise their options. Thus, contrary to an ordinary or authorised capital increase, the shareholders' pre-emptive rights are waived. Because of this, a conditional capital increase entails a dilution of the existing shareholders' rights. The ceiling of 50% authorised under Swiss law may therefore be too high, and Ethos decides how to vote on a case-by-case basis after having analysed the amounts requested and the underlying reasons.

When the conditional capital is intended for the conversion of bonds for which shareholders had a priority subscription right, Ethos respects the legal limit of 50%. However, if the shareholders' pre-emptive rights can be waived, Ethos sets the limit at 10%, unless the company presents due justification for requesting a higher amount.

On the other hand, when the conditional capital is to be used to convert stock options granted to the company's executives and employees under incentive plans, pre-

emptive rights are always waived. Ethos makes decisions on a case-by-case basis, in the light of the plans' characteristics, in particular eligibility and acceptable limits to the capital reserved for that and other company plans (for long-term incentive plans, see section 4, point 4.3.1 C.).

As in the case of authorised capital, the shareholders should analyse conditional capital requests bearing in mind the total potential dilution resulting from all authorisations.

## 6.3 CAPITAL REDUCTION

### 6.3.1 SHARE REPURCHASE AND CANCELLATION

In some countries, companies must seek shareholder authorisation to repurchase their own shares if they intend to cancel them. Share repurchases followed by the cancellation of shares lead to a reduction in share capital. This is a way of returning capital to the shareholders when the free cash flow exceeds investment needs.

In Switzerland, company law provides that a company may hold at most 10% of its own shares. Beyond this limit, the company must either reissue shares or cancel them and reduce its capital accordingly. If the shares are cancelled, the shareholders must approve the reduction in capital. Therefore, if a company wants to repurchase more than 10% of its capital it should ask authority from its shareholders to repurchase and subsequently cancel the shares exceeding this threshold.

Any proposal by a company with a significant cash flow to buy back its shares in order to reduce its capital must be justified by the



board of directors. The board must explain clearly to the shareholders why, for example, the surplus cash is not used for new investments or acquisitions.

In Switzerland, certain companies ask shareholder authority to repurchase shares in replacement of a dividend. However, a share buyback should not be confused with the payment of a dividend, as the buyback consists in a reimbursement of capital to shareholders, while the dividend is a distribution of profits. This practice is not beneficial for long-term investors such as pension funds that do not want to sell their shares. The shareholders that would sell their shares on a second trading line would also be disadvantaged, given that any gain realised by the sale is taxable. In addition, shareholders will bear transaction costs, which is not the case for a cash dividend payment.

### 6.3.2 REIMBURSEMENT OF PAR VALUE

Finally, capital can be reduced by reimbursing part of the par value of shares, thereby returning capital to the shareholders, sometimes in lieu of or in addition to a dividend. Unlike the dividend, the reimbursement of par value is not subject to tax.

The decrease in capital via par value reduction can nevertheless negatively affect shareholder rights. Indeed, when the right to place an item on the agenda of the annual general meeting is contingent on holding a certain amount of nominal value, a reduction in capital undermines the shareholders' rights unless the company amends its articles of association to reduce the minimum nominal

amount required to place an item on the agenda accordingly.

In fact, given that the right to put an item on the agenda is a fundamental shareholder right, a decrease in share capital (by cancelling shares or by reducing their par value) without a concomitant decrease in the value of shares required to exercise that right constitutes a deterioration of shareholders' rights, which is not acceptable, unless it is negligible.

### 6.3.3 THE SWISS CASE: THE CAPITAL FLUCTUATION MARGIN

As mentioned in chapter 6.2.4 B, Swiss law introduced on 1 January 2023 the system of a capital fluctuation margin, whereby the annual general meeting gives the board of directors the right to proceed, at its own initiative, to successive increases or decreases of the capital, up to the authorised amount, for a limited period of five years. The upper limit may not exceed one and a half times the share capital entered in the commercial register, and the lower limit is set at half the share capital entered in the commercial register (Art. 653 ff., para. 2 CO). The articles of association may provide that the fluctuation margin only allows an increase or decrease of the capital (Art. 653s, para. 3 OR).

The board of directors can therefore theoretically be authorised by the shareholders to reduce the share capital by half by means of a share buy-back accompanied by a cancellation of the shares or by a repayment of the nominal value of the shares during a period of 5 years without going to the general meeting. In view of the significant consequences that a capital



decrease may have for the shareholders, Ethos considers that the authorisation to decrease the capital within the framework of the capital fluctuation margin should be limited to 5%. For larger capital decreases, companies should make a request at the general meeting to inform shareholders of the precise reasons and conditions of the capital decrease so that they can vote in an informed manner on a proposal that may have a non-negligible impact on their rights.

## 6.4 SHARE REPURCHASE WITHOUT CANCELLATION

In several countries other than Switzerland, requests to repurchase shares (without cancellation) are a standard item on the agenda of annual general meetings because companies wish to have room for flexibility, for various reasons:

- To finance share based incentive plans without issuing new capital.
- To intervene on the market in order to support the share price.
- To finance acquisitions through share exchanges.
- To increase control over the company by one or more shareholders.
- To increase the share price in the short term with a view to exercising stock options.
- To hinder a hostile takeover bid (see 5.5.E).

In view of the above, it is important to be particularly attentive to the reasons underlying a repurchase. Several countries regulate share repurchases in order to protect the shareholders. Depending on the country, provision may be made for a

maximum repurchase rate with respect to the issued capital, a repurchase price bracket, the obligation to inform shareholders of the motives underlying the repurchase, the prohibition of selective repurchases that could discriminate against certain shareholders, and limitation of the authority in time. These restrictions may to some extent protect the company from its own attempts to manipulate the stock price by creating an artificially high demand for its shares and prevent share repurchases from becoming an anti-takeover measure.

## 6.5 PROTECTION MEASURES

Multiple measures may be taken to protect the company from an “opportunistic” shareholder or a hostile takeover bid by a third party.

In principle, institutional investors, shareholder associations and codes of best practice in corporate governance do not support such measures because they do not foster good management and enhanced performance within a company. By entrenching management, these measures may thwart takeovers that could put into question the company’s management and enhance the company’s potential and growth.

However, if the company’s long-term survival and the interests of the majority of stakeholders are at risk protection measures can be justified. This may be the case, for example, when a competitor plans to purchase the company in order to wind it up, to delocalise production or to resell it “piece by piece”, thus putting numerous jobs at risk. Under such circumstances, the measures



must be duly justified, limited in time, and submitted to the shareholders' approval.

The main anti-takeover strategies are described below.

### Different classes of shares

In order to strengthen control of the company by certain shareholders, a company may have several classes of shares that confer different voting or pecuniary rights, contrary to the one share = one vote principle. Depending on the country, the share capital may consist of shares carrying enhanced voting or pecuniary rights (with regard to the dividend, pre-emptive rights, and rights of redemption or additional parts on the proceeds of liquidation). In Switzerland for example, some companies have two classes of shares with different nominal values but equal voting rights. This enables some shareholders to control a company with a lower investment since shares of a lower nominal value have the same voting rights as shares of a higher nominal value. In some cases, the shares with a lower nominal value are not listed and held by the founding family or a major shareholder.

In principle, Ethos is opposed to capital structures with privileged voting rights. In such a case, the ratio between the nominal value of the different classes of shares should not exceed one to two.

### Limitation of the right to transfer or to register shares and of the right to vote

The "one share = one vote" principle may sometimes run counter to the long-term interests of the company and its stakeholders. In fact, given the low

participation of shareholders at general meetings, it is often sufficient for a shareholder (or a group of shareholders) to acquire around 20% of the share capital to take control of the vote and impose his (their) decisions. In such cases, voting rights restrictions can protect companies from attacks by opportunistic shareholders who want to outsource production, eliminate a competitor or dismantle the company.

In some countries, including in Switzerland, companies are entitled to set a limit in the articles of association with respect to the shares that a shareholder can register. The company can therefore set a cap (in percentage of shares) above which it is not obliged to consider an acquirer as a shareholder with voting rights. These restrictions concern registered shares, but also bearer shares when their holders are known. In most cases, the restriction does not apply to all the shareholders, which enhances inequality.

If the company has set limits, or intends to limit in the articles of association the shareholders' right to register shares, the articles of association should expressly provide that the annual general meeting may, at any time, waive that limit at the request of a shareholder and that such waiver may only be granted by decision of the general meeting. This gives all shareholders the power to decide, on a case-by-case basis, whether the request is justified, thereby shielding companies from de facto control by opportunistic shareholders with a limited investment but also from management entrenchment.

Indeed, unequal capital structures and voting rights limits generally serve to prevent changes of control and external influences, thereby entrenching management. By



shielding managers of poorly performing companies from market pressure, such measures can have a negative impact on the company's capacity to innovate and remain competitive in the long run. Where there is reason to consider the relevance of an unequal capital structure in the light of the company's history and its specific situation, such structures must be regularly reviewed and the relevance of measures contravening the "one share = one vote" principle regularly reconfirmed.

### Obligation to make an offer

In Switzerland, the law on financial market infrastructure provides that an investor must make an offer to acquire all listed securities if he acquires shares that (with the ones that he already owns) represent more than 33<sup>1</sup>/<sub>3</sub>% of the voting rights. To ensure the equality of treatment of all shareholders, the payment of a control premium is prohibited. In fact, the offer price must be the higher of (1) the average market share price in the 60 days before the offer and (2) the highest price that the buyer paid for a share of the company in the last 12 months.

However, companies may introduce in their articles of association a provision that completely frees the buyer from the obligation to make an offer (opting out clause). Companies also have the possibility to raise in their articles of association the threshold triggering the obligation to make an offer, setting it at a maximum of 49% of the voting rights (opting up clause).

These possibilities to waive the obligation to make an offer were introduced in the legislation to grant flexibility to major shareholders. In fact, the opting out and opting up clauses allow major shareholders

not to make an offer for all listed securities in case they cross the threshold when buying a few additional shares.

However, these provisions also enable a major shareholder (who owns more than a third of the voting rights) to sell his stake with a significant premium and without obligation for the buyer to make an offer for all listed securities, which strongly penalises the minority shareholders. For Ethos, these clauses bypass the original purpose and become instruments allowing major shareholders to realise a premium, and therefore an incentive to sell the company rather than a protective measure. The control premium that a buyer would pay (and thus the incentive to sell for the major shareholder) is especially high in a company with a dual class of shares, where the buyer can take control of the company with a minority of the capital.

In the light of the above considerations, Ethos considers that the companies should not include opting out or opting up clauses in their articles of association.

### Supermajority vote requirements

In some cases, the law or a company's articles of association require that certain general meeting decisions be taken by a qualified majority. In Switzerland, for example, certain decisions require the affirmative vote of a two-thirds majority of the votes and an absolute majority of the nominal shares represented. The supermajority vote requirements can therefore enable management to protect itself from proposals it does not approve, to the detriment of the shareholders and the other stakeholders.



### Share repurchases and “White Knights”

In some cases, share repurchases may provide protection against a takeover bid. According to this strategy, a company that is facing a hostile takeover bid transfers large blocks of shares to a “White Knight” who is an entity favourable to the company’s board and management.

### Capital increase or “Poison Pill”

In the United States and in Canada, when a shareholder reaches the 15-20% threshold, or when a hostile takeover bid is announced, some companies automatically increase the share capital and place shares with existing shareholders, at a sharply reduced price (generally half the market share price). This procedure, known as a “poison pill”, makes the takeover more onerous for the purchaser.

Canadian legislation requires that companies seek shareholder approval before introducing a “poison pill”. This is not the case in the United States. According to codes of best practice, such measures should not be adopted by the board without shareholder approval.

“Poison pills” were massively introduced in Japan as of 2005, to prevent foreign investors from gaining control of Japanese companies.

In Europe too, a company’s articles of association can authorise an automatic capital issuance for existing shareholders (at a purchase price that is less enticing than a “poison pill”), in order to make the takeover costlier for the purchaser.

## 6.6 INDEPENDENT PROXY

In Switzerland, to facilitate the exercise of voting rights for shareholders who cannot physically attend the general meeting, the Code of Obligations requires companies to appoint an independent proxy. The existence of an independent proxy is essential for shareholders to be able to exercise their voting rights remotely by communicating their voting positions in advance. According to the Code of Obligations, the independent proxy is elected annually by the shareholders.

For Ethos, independence is a fundamental quality that a shareholder representative must have in order to be credible with investors.

The Code of Obligations mentions that the independence criteria of the audit company apply by analogy to the independent proxy of the shareholders. In particular, close links between the management bodies of the company or a major shareholder on the one hand, and the independent proxy or persons close to him on the other hand, are incompatible with the notion of independence of the shareholder representative.



# 7. Mergers, Acquisitions, Spin off and Restructuring

## 7.1 GENERAL REMARKS

Mergers, acquisitions, spin off and restructuring are generally large-scale transactions with far-reaching long-term consequences for all the company's stakeholders. The interests of the various parties do not necessarily coincide, however, particularly in the short term. It is therefore very important to analyse a merger, acquisition or restructuring from a long-term perspective that considers all future consequences, not only for the shareholders, but also for the other stakeholders, including company personnel, clients, suppliers and any members of civil society that might be directly impacted by the transaction.

The stated purpose of most mergers is to maximise a company's value, but it must never be forgotten that mergers also present major risks. These risks include:

- Problems relating to the integration of two separate and often competing entities with different company cultures, which may, among others, undermine staff motivation.
- The amount of the premium, which is supposed to represent the value of the synergies expected from the merger. More often than not, the premium paid (goodwill) far exceeds the value of the effective synergies and must be written off rapidly following an impairment test (according to IFRS).
- The financial cost of the transaction, in particular one-time restructuring costs.

The social implications of mergers, acquisitions and restructuring require the

shareholders to show great prudence when they are called on to give their approval. They must have the means of ascertaining that the transaction is to the advantage of all stakeholders. They should strive to avoid endorsing an operation that serves solely to further the interests of management. Particular attention must be paid to any conflicts of interest that may arise for executives, who may be tempted to privilege their own interests through the new structure and advance their career, improve their remuneration or receive transaction bonuses. Such objectives may not necessarily coincide with the long-term interests of the minority shareholders and other stakeholders, notably the employees. It would therefore be of great value to create a special committee including only independent directors with no personal or professional interests in the operation, to review and appraise the proposed transaction.

It is admittedly difficult, in particular for the shareholders, to foresee exactly what long-term effects a merger, acquisition or restructuring will produce. However, it should be possible for them to carry out a reasonably in-depth analysis of available information. In this respect, the quality of the information disclosed and the justification provided by the company, including the "fairness opinion" drawn up by a competent institution such as an investment bank or specialised consultant, play a decisive role in the acceptance or rejection of the proposal. The institution entrusted with the appraisal of the transaction should be independent



and objective (free of any business connection with the relevant companies) and unencumbered by the board's interference in its analysis of the transaction. To guarantee independence and objectivity, codes of best practice recommend that the fairness opinion be entrusted to an organisation that has no important business relations with the companies concerned.

Moreover, as remuneration for such work generally consists not only of a fixed fee but also of a variable one that largely depends on the value of the transaction and its execution, there is an additional source of conflicts of interest, which should be closely monitored by the shareholders.

Lastly, a study of the new entity's governance should be carried out to assess the impact of the merger on the shareholders' rights and on their long-term interests and those of other stakeholders.

## 7.2 ACQUISITION OR MERGER BY ABSORPTION

When an acquisition or merger by absorption takes place, one company takes over the assets and liabilities of another company during the course of a universal succession. The transaction may take place between companies within the same economic sector (horizontal integration) or between a company and a major client or supplier (vertical integration). The objective of such transactions may be to create synergies, to diversify, to increase prospects for the company's products, to increase cash flow or improve creditworthiness, or to lower fixed costs by achieving economies of scale (particularly in the case of horizontal integration).

The merger contract is always submitted to the general meeting of the company that will be absorbed or acquired. When the latter is dissolved without liquidation, its shareholders are allocated shares in the acquiring company. This transaction is implemented through a contract that provides for the exchange ratio between the shares of the acquired and the acquiring company. Generally, the shareholders of the absorbed company have an immediate financial interest in the transaction, since the announcement of the operation usually leads to a considerable increase in the value of the company's shares. Unfortunately, for this reason, the debate concerning the advisability of the transaction is frequently limited to establishing whether management has succeeded in negotiating an optimum deal as represented by the share premium that the acquiring company has offered.

The acquiring company is generally not required to submit the merger to its shareholders for approval, unless the operation involves a substantial increase in capital to cover the anticipated exchange of shares. In Switzerland, the board of directors approves the merger, except in situations that call for modifications to the articles of association (change of the company's registered purpose, increase in capital, creation of a new class of shares, change in the number of members of the board). However, the shareholders need not be consulted if the company has sufficient shares of its own or if the articles of association entitle the board to increase the authorised capital to carry out the transaction.

If the capital is increased, the future advantages of the operation must adequately compensate for the dilution of profits and voting rights (see 5.2 on capital



increase). The transaction may also have other consequences for the structure of the company (for example in terms of corporate governance), which should be also examined in the light of best practice standards and the long-term interests of the company's shareholders.

### 7.3 MERGER BY COMBINATION

In a merger by combination, two or more companies, which may or may not belong to the same economic sector, contribute their respective assets and liabilities to form a new company. The merger must be approved by the annual general meetings of both companies. Following approval, the new company can be formally constituted and the shareholders of the dissolved companies receive shares in the new entity.

As in the case of mergers by absorption, the operation must be examined in the light of the long-term interests of all stakeholders. Moreover, a careful study should demonstrate that the structure of the newly formed company complies with standards of best practice in corporate governance. In this respect, particular attention should be paid to the composition of the board of directors and the capital structure.

### 7.4 SITUATIONS AKIN TO MERGERS

In everyday language, the term "merger" is often used to designate procedures that, from the economic point of view, are akin to mergers but should not be qualified as such from a legal point of view. The two main situations that are similar to mergers, "so-

called mergers" and "quasi-mergers", are briefly described below.

"So-called mergers" occur when one company (or a part thereof) transfers its assets and liabilities to another in return for either cash or shares in the other company. If the shareholders' general meeting agrees, the company that has been taken over can subsequently be liquidated, which is not really what happens in a true merger, when the company is never liquidated (see 6.2 above). The shares or cash thus obtained are paid out as liquidation proceeds to the shareholders of the company that has been taken over.

A "quasi-merger" occurs when one company takes over all (or at least most) of the shares of another company and maintains the latter as a subsidiary. This type of procedure results in the creation of a group. In some cases, the subsidiary is subsequently absorbed by the parent company.

### 7.5 COMPANY SPIN-OFFS

When a company decides to withdraw from a given sphere of activity in order to concentrate on another area, it may proceed to a spin-off operation.

Such a course of action is often undertaken when the synergy between a particular sphere of activity and the company's other activities is weak, and when the proposed operation offers greater potential for growth on both sides. A spin-off may also prove effective when a specific sector of a company's activities is undervalued. When separated from the rest, the market would be more likely to recognise it at a better value



A spin-off takes place when one company transfers to another a specific part of its own activities and can take different forms. The shareholders of the parent company can receive participation rights in the new company to compensate for the loss of substance of the original company. The spun-off company will become independent and its shares will be listed on the stock market.

The parent company can also sell a division and return to the shareholders all or part of the proceeds of the sale in the form of a dividend corresponding to the value of the sold activities.

When a spin-off operation leads to a reduction in capital, it must be brought before the shareholders of the parent company for their approval. It is essential to ensure that the transaction is to the advantage of the stakeholders of both companies. Furthermore, the structure of the new company must comply with the principles of best practice in corporate governance. In this respect, particular attention should be paid to the composition of the board of directors and the capital structure.



# 8. Amendments to the Articles of Association

## 8.1 GENERAL

The articles of association are the legal foundation on which a company's existence is based. They contain the provisions that are essential to its activities, namely its registered name, headquarters, corporate purpose, capital structure, the competencies of its bodies, and its shareholders' rights and obligations.

Proposals to amend the articles of association are generally prompted by the need for a company to adapt to new situations. They may stem, for example, from changes in the national legislative or regulatory framework, including the adoption of a new law or stock market regulations or the establishment of jurisprudence.

Amendments to the articles of association may involve the mere rewording in an article, the amendment of several articles, or even a complete reformulation of the document.

Some amendments are of editorial nature, while others concern fundamental issues such as capital structure, the shareholders' voting rights, the composition of the board of directors, the external auditor's election and term of office, and the allocation of company income. These subjects are dealt with separately in other sections of this booklet, and voting positions on them are to be defined in accordance with the voting recommendations pertaining to the relevant section.

Amendments to the articles of association may also concern less important issues, for

example voting procedures, conditions for admission to annual general meetings, shareholder representation at meetings, and administrative matters relating to securities.

However, an apparently minor or purely technical amendment may have a significant impact on shareholder rights. It is therefore essential to carefully review the content of all proposed amendments to the articles of association. For this reason, the company should provide the shareholders with the complete text of all the proposals and not just a summary.

According to best practice, the annual general meeting should be entitled to a separate vote on each separate amendment and not to a bundled vote of all the amendments proposed. A series of amendments may contain some proposals that have a positive impact on shareholders, while others have a negative impact or are simply neutral. Bundling the proposals in a single vote would leave the shareholders with no choice but to accept or reject them as a whole.

If the shareholders are nevertheless called upon to vote on a bundled series of proposals, they must weigh the negative proposals against the positive to assess the overall effect on their long-term interests.



## 8.2 SITUATION IN SWITZERLAND

The articles of association of Swiss companies must contain specific provisions governing the functioning of the governing bodies.

### 8.2.1 MAXIMUM NUMBER OF MANDATES

To ensure that the members of the governing bodies are sufficiently available to exercise their function with the required diligence, the maximum number of mandates exercised by the members of the board of directors, the advisory board and the executive management within management or administrative bodies of other legal entities must be laid down in the articles of association.

Ethos believes that it is important to provide for a different maximum number of mandates for the members of the executive management and for the non-executive members of the board of directors. Furthermore, in each of the two cases, a distinction should be made between mandates in listed companies, for-profit companies and other institutions.

These distinctions aim to be able to better assess the workload that the maximum number of admitted mandates requires. This should make it possible to determine whether the members of the board of directors and of the executive management are able to exercise their activity and assume their responsibilities with due diligence.

The question of the maximum number of mandates admitted by Ethos is dealt with in appendix 2 of the voting guidelines.

### 8.2.2 REMUNERATION SYSTEM AND EMPLOYMENT CONTRACTS

The Code of Obligations further provides that the articles of association of Swiss companies include specific provisions on the maximum length of employment contracts of management bodies.

To prevent the provisions of the employment contracts of members of the executive management from circumventing the prohibition on paying severance pay by providing for long notice periods or particularly long contracts, the maximum length and maximum notice periods must be fixed in the articles of association. According to the CO, the length and period of notice cannot exceed one year. However, it is not specified to what remuneration the employee is entitled during the notice period (fixed salary and target bonus, total remuneration including allotments of shares or options, etc.). Ethos believes that in principle only fixed remuneration should be paid if the employee has been made redundant and has not worked during the notice period.

It should be noted that the CO prohibits the payment of severance pay. As a replacement, many companies have included in their articles of association the possibility of providing paid non-competition clauses to the members of the executive management. In principle, the articles of associations specify the duration of such clauses and the remuneration to which the beneficiaries will be entitled.



### 8.2.3 8.2.3 VIRTUAL GENERAL MEETINGS

Swiss companies may hold their general meetings in electronic form and without a physical meeting place if their articles of association so provide (Art. 701d CO).

However, the board of directors must ensure that the speeches at the general meeting are broadcast live and that any participant can make proposals and take part in the debates (Art. 701e CO).

Ethos considers that it is essential to maintain a physical meeting place while allowing shareholders to vote and intervene remotely (hybrid format) in order to give shareholders a free choice as to the meeting place and to guarantee a direct contact between the board of directors and the shareholders of the company at least once a year. The exclusively virtual format should be reserved for cases of force majeure (pandemic, natural disaster, etc.).

Therefore, the introduction in the articles of association of the possibility of holding virtual only general meetings can be supported by Ethos if the hybrid format is guaranteed and if exceptions for cases of force majeure are expressly mentioned.



## 9. Shareholder Resolutions

### 9.1 HISTORY

Shareholder resolutions, which date back to the late 1920s in the US, were initially a means of obtaining information from management. Subsequently, in the 1970s, religious organisations (but not only), grouped together in their capacity as shareholders in the Interfaith Center for Corporate Responsibility (ICCR), began to submit resolutions, in their capacity as shareholders, which sought to promote ethical values such as peace and the principles of social justice in the business community and society at large. The resolutions originally aimed to ensure respect for human rights in repressive political regimes, but they have since evolved to include the need to promote and respect quality standards in the workplace, notably in the spheres of security, equality and non-discrimination.

Since the establishment in the mid-1980s in the United States of the Council for Institutional Investors (CII), the inception of rules aimed at promoting good corporate governance has become a major concern for institutional investors.

The Coalition for Environmentally Responsible Economies (Ceres) was created in 1989, after the Exxon Valdez disaster. It is an umbrella organisation for investors working to convince companies to adopt a series of environmental principles to be presented annually to the shareholders in the form of standardised reports. Ceres currently has 130 members that “mobilise a powerful network of investors, companies and public interest groups to accelerate and expand the adoption of sustainable business practices

and solutions to build a healthy global economy.”

Nowadays, shareholder resolutions are becoming increasingly diverse and are used as a means of influencing corporate strategies, social and environmental policies, and corporate governance. They are common practice in the United States and Canada and also exist in other parts of the world, such as Europe and Japan.

The rights of shareholders and their ability to put resolutions before annual general meetings vary from country to country. In the United States, for example, a shareholder need only own shares worth USD 2,000 for one year in order to put a resolution on the agenda of an annual general meeting. However, when companies wish to prevent a proposal from being presented at the shareholders’ general meeting, they can seize the SEC, which has the authority to decide whether to exclude the proposal or not. In fact, as shareholder resolutions have progressively become a means for active shareholders to influence company strategy, the SEC regularly revises its rules regarding acceptability of resolutions. It sometimes puts forward technical or juridical reasons for limiting the number and scope of resolutions that can be voted on by the shareholders.

In Switzerland, unless otherwise stipulated in the company’s articles of association, a shareholder (or group of shareholders) must hold shares corresponding to a par value of at least 1 million Swiss francs (or 10% of the share capital) in order to put an item on the agenda. Since there is considerable difference between a share’s par value and its market price, such a requirement makes it



very difficult to submit resolutions because the shareholder often has to hold shares amounting to a market value of tens of millions of francs.

In Germany, where the submission of resolutions is subject to conditions similar to Switzerland's (the shareholder(s) must represent shares totalling at least EUR 500,000 in par value), minority shareholders attempt to circumvent the problem by submitting "counter-proposals" to the different proposals of the board instead of resolutions. Counter-proposals may be numerous and wholly unrelated to each other in substance. Since they can be introduced at various points on the agenda, they are generally presented in connection with approval of the dividend and requests to grant discharge to the Management board and Supervisory board. The board reads the counter-proposals to the shareholders, who are subsequently called upon to approve or reject the specific item on the agenda and not the counter-proposal itself.

As a result, it sometimes happens that shareholders put forward a counter-proposal criticising the company's involvement in a controversial field. Shareholders who agree with the substance of such a counter-proposal would then have to oppose, for example, the dividend distribution or withhold discharge. Although such counter-proposals are unlikely to win sufficient support among the shareholders, they nevertheless provide the proponents with an opportunity to draw the general meeting's attention to certain important matters.

## 9.2 ANALYSIS OF SHAREHOLDER RESOLUTIONS

Each shareholder resolution must be subject to an in-depth analysis. However, certain rules of best practice apply to all shareholder resolutions.

A resolution should be clearly expressed and accompanied by detailed explanations concerning its objectives and the means of implementation proposed to the company. The feasibility of the proposals must be demonstrated in order to justify its endorsement by the shareholders. Hence, if the targeted objectives go beyond a company's authority and fall within the remit of Government, the resolution should not be approved. A resolution is not acceptable either when it aims at micro-managing a company by delegating decisions to investors that belong to the board or the executive management.

Some investors are only interested in proposals that aim at enhancing shareholder value. However, for other shareholders, including the Ethos Foundation, resolutions are acceptable if they aim at enhancing long-term corporate value, not only for shareholders, but also for the majority of the other stakeholders.

Generally speaking, shareholder resolutions can be divided into three broad categories.

### Corporate Governance

The first category consists of resolutions that concern corporate governance matters. Such resolutions aim at encouraging the company to improve its corporate governance, primarily to ensure that boards discharge their duties in the best interests of



companies and their shareholders, thereby creating long-term value.

In this respect, Ethos lends its support to resolutions that aim at aligning company practices to best practice in corporate governance. Ethos approves resolutions that promote greater transparency and disclosure of information, ensure equal treatment of shareholders, ask for separation of the functions of chairman and CEO, introduce annual election for directors and majority vote for board election, reduce the shareholdings required for convening an extraordinary general meeting, align the interests of managers and shareholders in terms of remuneration, or ask for information with regard to political spending by companies.

### Environmental resolutions

The second category involves resolutions concerning the environment. These resolutions aim at increasing a company's awareness of the environmental issues raised by its activities and at encouraging the company to limit or minimise the impact of its activities on the natural environment. Generally, Ethos considers that the companies should put ambitious climate change strategies in place and enhance the protection of the natural environment.

This is precisely the objective of environmental resolutions that require, for example, companies to prepare sustainability reports, adopt and publish quantitative and challenging targets of greenhouse gas emissions reduction to mitigate climate change, develop policies regarding waste management, water usage, or limit productions that release pollutants in the atmosphere. Certain resolutions also ask

companies to assess the challenges related to climate change or prepare a report on "carbon risks", i.e. the risks related to stranded assets that cannot be utilised because they are too carbon-intensive.

### Social resolutions

The third category includes resolutions designed to increase a company's sense of social responsibility towards its stakeholders, including employees, customers, suppliers, local authorities and civil society at large. Such resolutions may also address the social impact of the company's products and practices.

Generally, Ethos considers that companies should adopt high standards in terms of human and workplace rights and enforce them, not only in their country of domicile, but also all along the supply chain.

Ethos urges companies to put codes of conduct and anti-corruption mechanisms in place, to take measures aiming at reducing workplace accidents and to promote diversity and non-discrimination.

When company practices are not adequate and a resolution aims to remediate such a situation, Ethos will approve the resolution. This is notably the case for resolutions when asking companies to increase employee diversity, establish and enforce anti-discrimination policies, introduce independent monitoring of the implementation of its code of conduct, prepare a report on measures to reduce accidents, implement a policy to make medicines affordable to poor citizens, or to guarantee liberty of expression on the Internet.



### 9.3 IMPACT OF SHAREHOLDER RESOLUTIONS

Shareholder resolutions are the last step in a communication process between the shareholders and management. Bringing about a change in a company's "attitude" or practices is a process that is usually successful only after sustained and good quality dialogue. However, when constructive dialogue is not possible, or if it does not bear fruit within reasonable deadlines, a resolution enables the proponents to raise awareness of other shareholders and civil society on their concerns and to send a signal to the company.

Generally speaking, shareholder "campaigns" use several means simultaneously to advance their cause, such as dialogue, the submission of resolutions and other means of external pressure. Although the resolutions are usually submitted following genuine attempts at dialogue, combining the dialogue with a resolution can speed up the process and bring about tangible results in shorter deadlines.

The approval rate of a resolution is very important, in particular in order to send a strong signal to the company's management regarding shareholders' concerns. Many resolutions, however, obtain no more than 10% of votes, at least the first year. Moreover, in some countries, such as the United States, they are generally non-binding, which means that the outcome of the vote is purely advisory. The board of directors is not obliged to implement the decision, even if it has been supported by a majority of shareholders. However, when a majority of shareholders approve a resolution, the board of directors is placed under heavy pressure to take account of it, at the risk of not being re-elected by the shareholders.



## 10. Other business

The “Other business” item on the agenda of the annual general meeting usually covers matters that require consideration but are not put to the vote. Nevertheless, companies sometimes submit to vote proposals that did not appear as items on the agenda. This procedure is not authorised in some countries. In Switzerland, the general meeting cannot decide on an item that was not on the agenda (except to call an extraordinary general meeting, to conduct a special audit or to elect an audit firm). The shareholder may make additional proposals or counter-proposals to the subjects covered in the agenda.

The practice of introducing matters that do not appear on the agenda under the heading “Other business” is a contentious issue. It is much criticised by investors and consultants in corporate governance, particularly when the acceptance of the matter requires the approval of the majority of shareholders actually present at the annual general meeting. This serves to exclude the vast majority of investors, and notably institutional investors who traditionally vote by proxy.

In order to avoid ratifying proposals of unknown content, shareholders voting by proxy, and who are therefore not present at the annual general meeting, should not approve in advance an unknown proposal. It is therefore imperative that voting cards include explicitly the possibility for shareholders voting in advance to refuse any proposal announced during the general meeting, be it by the board or a shareholder.



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