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Corporate Governance
A spotlight on Swiss trends

Second Edition 2012

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Contents

Executive summary

Deloitte Switzerland is pleased to present a new study on the current corporate governance trends and practices in the Swiss market. As economic conditions remain challenging, the need for robust governance and leadership is crucial, and there is an increasing demand for more transparency and visibility on the actions of the board and its chairman. In addition to a call for more independence at board level, there is also more scrutiny over the board's oversight of the CEO and executive committee's implementation of board decisions. Setting appropriate and acceptable levels of remuneration is critical – and 2013 will see a Swiss public vote on the Minder Initiative which could bring more regulation in this area.

Our analysis examines the companies comprising the Swiss Market Index (SMI) and the SMI MID (SMIM) index, together defined as the SMI Expanded, representing the 50 largest equities in terms of market capitalisation. We focused on publicly available corporate governance disclosures made in the 2011 annual reports, as well as information available on the companies' websites.

We also focus on two specific topics which raised interest following last year's study: evaluation of board performance and risk oversight. Our research shows that disclosures in these areas are limited. While 80% of SMI companies declared that an evaluation of the board is performed (which is a 20% increase over last year), the method, scope or content is rarely communicated publicly. Likewise, there is a lack of transparency over risk oversight and what exactly Swiss boards are doing to manage their risks effectively.

The views of key stakeholders

As well as analysing disclosures and comparing corporate governance practice to worldwide and European practices, we also sought the views and opinions of a number of stakeholders including independent board members, audit committee chairs, analysts and professional associations (such as economiesuisse and Ethos Foundation) and we include their observations on key topics such as board independence, gender diversity and the Minder Initiative.

Are board members truly independent?

86% of board members are declared as being independent by Swiss listed companies.[1] In Switzerland, however, there is no set or legal definition of independence and most companies follow the Swiss Code of Best Practice on Corporate Governance's guidelines, which are broader than in several other countries. Definitions and guidelines vary by country and are often more restrictive in some European countries. This makes meaningful comparison with Europe very difficult and in reality, Swiss boards may not be considerably more independent than in Europe. This opens the debate on best practices in board member independence.

Are quotas the solution for gender diversity?

Few women make it into senior management and director roles and Switzerland continues to lag behind Europe in terms of gender diversity, with only 9% of board members being women (12% in Europe). There are even fewer in the SMIM compared to the SMI which consists of more Swiss-based companies rather than global *powerhouses*. Quotas have been introduced in a number of neighbouring European countries, but are not yet on the horizon in Switzerland for the private sector, although we are seeing moves towards quotas in the Swiss public sector. Quotas would clearly speed up the diversity process – the increase in women in governance remains painfully slow. More women on boards would not necessarily "improve" governance, but would bring more diversity, differing viewpoints, which in turn would lead to a stronger collective board.

Communicating on governance – a new era of technology?

An increasing number of companies are moving towards electronic means of communication, moving away from heavy paper board packs, many now choosing a virtual board pack that can be consulted on directors' iPads using tailor-made Apps. As board members may sit on boards in a number of countries and are frequently travelling, we are seeing a wave of advancement in technology and new era of heightened accessibility and efficiency – subject to the appropriate safeguards against breaches of confidentiality.

1 SMI Expanded index

A need for more colour in corporate govenance disclosures?

Swiss corporate governance continues to evolve and we see more and more elements of "best practice". Several companies, however, still continue to see the corporate governance disclosures requirements introduced by the Swiss Stock Exchange (SIX) back in 2002 as a compliance exercise, or "box-ticking" rather than to add colour and transparency to their governance policies and procedures that surely exist in their day to day operations.

Remuneration on a downward trend?

Remuneration reports are becoming overly long and complex, it is often difficult to interpret them. We do notice a decrease in remuneration compared to 2010 at both the board and the executive level, which is mainly driven by the financial institutions, as a result of the difficult market conditions, combined with stricter cost control. The number of Swiss listed companies now implementing a facultative vote on remuneration levels has increased since last year, and the level of acceptance is generally high.

While this either suggests that pay levels are commensurate with management performance or that Swiss shareholders are mature and politically neutral, it does indicate that the Swiss marketplace is favourable to corporations and their prosperity. We now await the Minder Initiative vote which will bring a number of radical changes, including mandatory "say on pay" by shareholders and prohibition of severance payments.

Looking ahead – future developments

In the various domains, we look ahead to future trends and developments in governance, such as succession planning which is seen as a key priority for most companies, to audit committees focusing on identifying and developing financial talent, as companies face greater business challenge and a shortage of experienced finance leaders.

What is apparent is the increasing trend towards board professionalism, expertise and "leading practices" that can frequently be observed in other countries such as the UK or the US, but also quite often closer to home, in Swiss listed companies.

Conclusions

Overall, our study highlights a situation in Switzerland which is generally satisfactory but could be further improved: listed companies demonstrate through their publicly available communication on corporate governance an increasing level of interest and disclosures which conform to the current legislation. In some areas, however, disclosures could be enhanced. For example information on the board performance evaluation process or risk oversight remain so concise that it is not possible to gauge what level of priority or focus is given to these important topics. Despite this, a real movement is underway to ensure that corporate governance, a necessary ingredient for Swiss companies, continues to thrive in the current economic conditions.

Our team of corporate governance specialists would be pleased to respond to your questions on any of the matters raised in this report. You can find their contact details inside the back page of this report.

A note on methodology

The information and charts in the following pages of this brief are extracted from the 2011 annual reports of the companies making up the SMI Expanded index (comprising the SMI and SMIM indices) at the Swiss Exchange as at the end of June 2012. The SMI comprises the 20 largest companies by market capitalisation, and the SMIM comprises the next 30 companies.

SMI

Company	Activity	Company	Activity	Company	Activity
ABB	Industrials	JULIUS BAER	Financials	SWISS RE	Financials
ACTELION	Health Care	NESTLÉ	Consumer Goods	SWISSCOM	Telecommunications
ADECCO	Industrials	NOVARTIS	Health Care	SYNGENTA	Basic Materials
CREDIT SUISSE	Financials	RICHEMONT	Consumer Goods	TRANSOCEAN	Oil & Gas
GEBERIT	Industrials	ROCHE	Health Care	UBS	Financials
GIVAUDAN	Basic Materials	SGS	Industrials	ZURICH	Financials
HOLCIM	Industrials	SWATCH GROUP	Consumer Goods		

SMIM

Company	Activity	Company	Activity	Company	Activity
ARYZTA	Consumer Goods	LINDT N	Consumer Goods	SCHINDLER	Industrials
BALOISE	Financials	LINDT PS	Consumer Goods	SIKA	Industrials
CLARIANT	Basic Materials	LOGITECH	Technology	SONOVA	Health Care
DKSH	Industrials	LONZA	Health Care	STRAUMANN	Health Care
DUFRY	Consumer Services	MEYER BURGER	Industrials	SULZER	Industrials
FISCHER	Industrials	NOBEL BIOCARE	Health Care	SWATCH GROUP	Consumer Goods
GALENICA	Consumer Services	OC OERLIKON	Industrials	SWISS LIFE HOLDING	Financials
GAM	Financials	PARGESA	Financials	SWISS PRIME SITE	Financials
HELVETIA HOLDING	Financials	PARTNERS GROUP	Financials	TEMENOS	Technology
KUEHNE+NAGEL	Industrials	PSP	Financials	VALIANT	Financials

Our sample, looks at 47 reports and related disclosures for the following reasons: i) Lindt has two types of shares listed on the SMIM ii) Swatch Group has shares in both the SMI and SMIM indexes iii) DKSH entered the SMIM only in early 2012, replacing Geberit which moved up into the SMI. DKSH did not issue a corporate governance report in its 2011 annual report as it was not a requirement. We have drawn our statistics on European and US counterpart firms from the surveys of others. Particularly noteworthy are the 2011 Spencer Stuart Board Index and Heidrick & Struggles' Challenging Board Performance.

"Good corporate governance is generally expected. However, bad corporate governance can impact ratings negatively."

Responsible for Corporate Governance, a global ratings agency

The board of directors

The boards of directors of numerous companies have been increasingly in the spotlight over the last few years across Europe. Gone are the days where the role of the board director was a part time role before full retirement. These are pivotal roles dealing with challenging topics that shape the future for some of the biggest brands in the world. Our survey looks at how well placed the Swiss listed entities are to discharge their duties.

In April 2011, the European Commission issued its Green Paper on Corporate Governance. This heightened discussion around best practices in the European Union and established a link between sustainable growth and well managed companies.

The role of the board of directors for Swiss companies is clearly articulated in the Swiss Code of Obligations. The latest requirements have been in force since 1992 but the interpretation of what this means in practice is subject to continuous refinement as to what best practice is.

Board of directors' duties – Article 716a of the Code of Obligations:

1. The overall management of the company and the issuing of all necessary directives.
2. Determination of the company's organisation.
3. The organisation of the accounting, financial control and financial planning systems as required for management of the company.
4. The appointment and dismissal of persons entrusted with managing and representing the company.
5. Overall supervision of the persons entrusted with managing the company, in particular with regard to compliance with the law, articles of association, operational regulations and directives.
6. Compilation of the management report, preparation for the general meeting and implementation of its resolutions.
7. Notification of the court in the event that the company is over-indebted.

The board of directors may assign responsibility for preparing and implementing its resolutions or monitoring transactions to committees or individual members. It must ensure appropriate reporting to its members.

The constitution of an effective board

The board's composition is dependent on the sector or on issues faced by the entity. In general terms, diversity is more and more seen as driving better decisions in the board room. Another factor revealed by our study is that the composition and activities of Swiss and other European listed company boards are influenced by the characteristics of company ownership. For instance, in companies surveyed where there is a family or group that retains a substantial ownership interest, the board structure and operations of that board may be slightly different than in a company with a very diverse shareholder group. For example, there may be less delegation of duties to board subcommittees as all directors want to be involved in all governance aspects, or subcommittees are an extension of the main board meeting with all members present and involved.

Gone are the days where the role of the board director was a part time role before full retirement. These are pivotal roles dealing with challenging topics that shape the future for some of the biggest brands in the world.

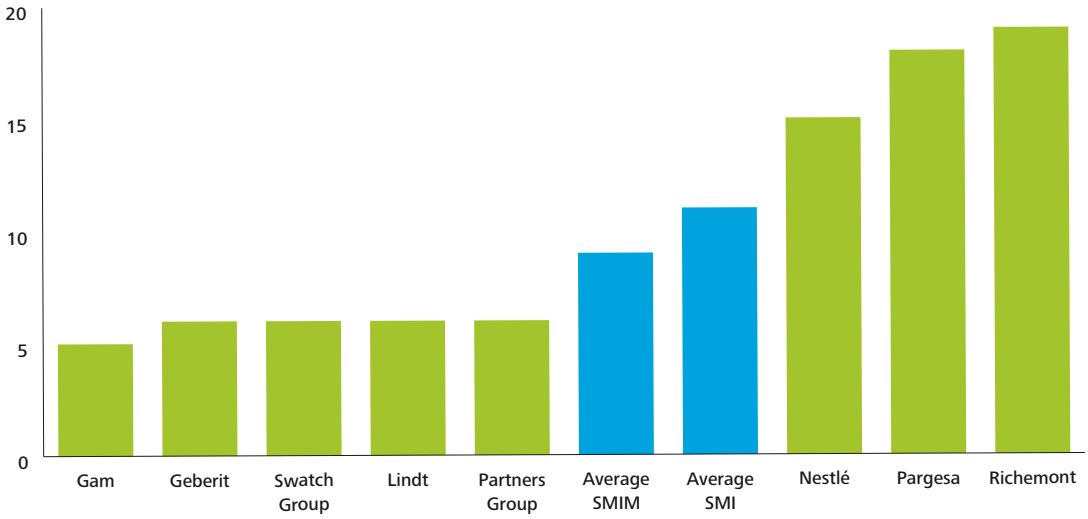
A Swiss SMI/SMIM board of directors

- Average board consists of 9.4 members (SMI: 10.6, SMIM: 8.6).
- Average age of board member is 59 years old (SMI: 60, SMIM: 58).
- Average length of service is 6.4 years (SMI: 5.8, SMIM: 6.8).
- 9% of board members are female (SMI: 11%, SMIM: 7%).
- 70 % of chairpersons are previously members of executive management.
- 86% of board members are defined by the company as being independent.

Board characteristics in Switzerland

Number of board members: It is good practice that a board should be organised to reflect the size and nature of the company it serves. The Swiss Code of Best Practice for Corporate Governance does not recommend a particular size for a board but recommends that it should be small enough to encourage decisions and large enough to favour the contribution of diverse members. The average SMI/SMIM board of directors consists of 9.4 members. This is in line with US companies which have on average 10.7 board members and below European companies which have on average 12.1 board members. In 2011, Richemont (SMI) has the highest number of board members, with 19 members, Pargesa (SMIM) and Nestlé (SMI) being just behind with respectively 15 and 18 members. At the opposite end of the scale, GAM (SMIM) has only 5 board members while Swatch Group (SMI), Geberit (SMI), Lindt (SMIM) and Partners Group (SMIM) have 6 board members.

Number of board members (highest, lowest, average)



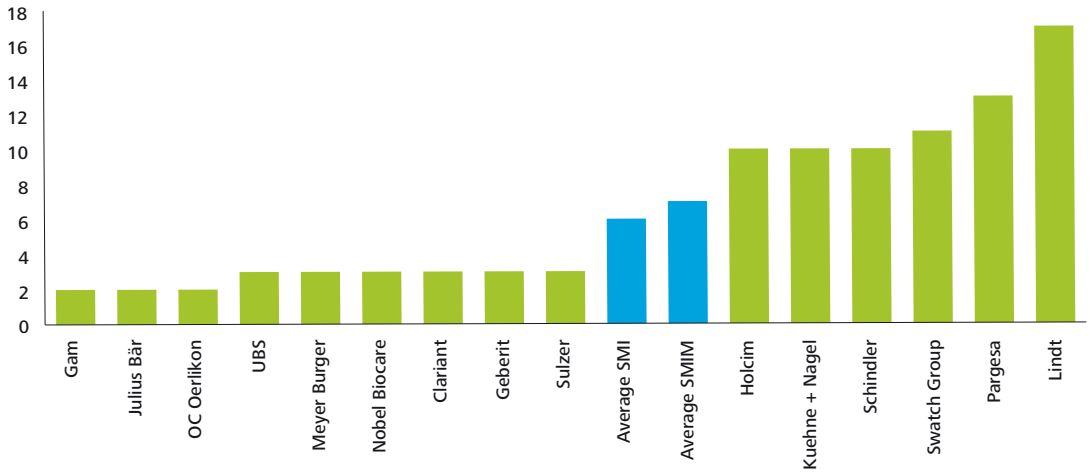
Length of board service: in Switzerland, there is no legal limit on the overall length of time a director may serve on the board, although a limit may be pre-defined by an individual company's board charter. The average length of service is of 6 to 7 years for board members of Swiss-listed companies. This is longer than the 2011 European average of 5.7 years. Julius Baer (SMI) and GAM (SMIM), as well as UBS (SMI), have on average board members who have stayed 2 to 3 years in service, mainly as a result of a recent reorganization. Other companies such as Lindt (SMIM, 17 years) or Swatch (SMI, 11 years) tend to keep a similar board structure for years.

The Swiss Code of Best Practice recommends that board terms do not exceed 4 years and advises to build a strong succession plan (a task of the nomination committee). We noticed only one company that has a board term policy exceeding the 4 years threshold – Dufry sets a maximum term of 5 years. Furthermore, some companies disclose a restriction on the maximum number of years a director can serve on the board, for example 9 years for Lonza and 15 years for PSP.

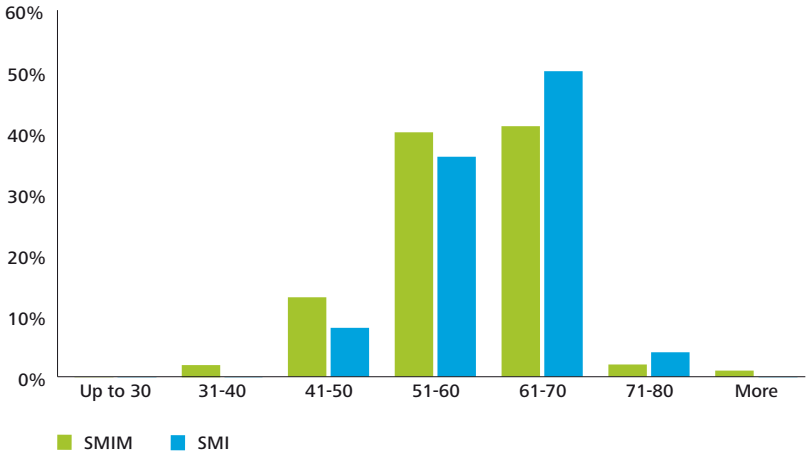
The main election modes are the annual election for 36% of the SMI/SMIM listed companies and the election once every 3 years for 38% of the panel. 93% of our sample individually elects its members (the remaining companies use collective elections process). We noted that during the Annual General Meeting approving the 2011 financial statements, on average 94% of the shareholders approved the election of the proposed board members. Every proposed board member was elected. This rate is relatively high in spite of increased shareholder challenge of board performance and company results.

Every proposed board member was elected by the Annual General Meeting in 2012.

Length of board service (highest, lowest, average)



Age of board members



Swiss SMI/SMIM boards have on average 50% of non-Swiss directors, which is much higher than the European average of 24%.

Average age of board members: board members of Swiss companies are on average 59 years old, which is in line with the 2011 European average of 58 and a bit less than the US average of 62. There is no legal age limit in Switzerland although some companies do impose an internal age limit. On average, our sample discloses an average age limit policy of 70 years. The youngest board member is 29 years old (Jassim Bin Hamad J.J. Al Thani, Crédit Suisse); the oldest is 85 years old (Albert Frère, Pargesa). 34% of the SMI/SMIM companies do not disclose any age limit for their board members.

Diversity of the board: diversity being promoted as a driver of new ideas or as an obstacle against *herding* behaviour where everyone has the same background and behaviour, we tried to identify whether Switzerland is a star pupil.

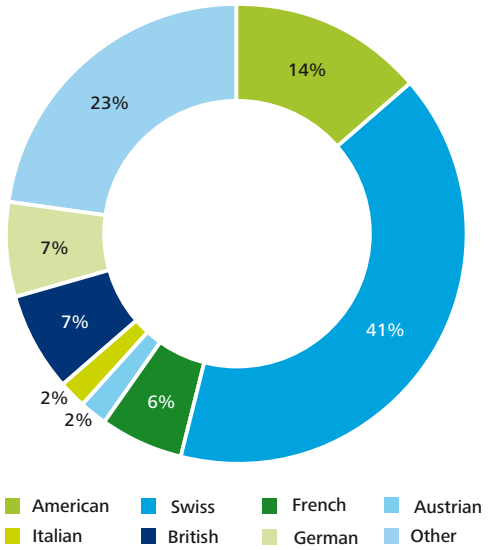
Nationality: Our review showed that 59% of directors on the SMI and 41% on the SMIM are non-Swiss nationals compared to only 24% across Europe. This is probably a reflection of the truly global nature of many of the companies that we looked at. There were exceptions though with over 10% of the companies with an all Swiss national board and one company with no Swiss members at all. Companies such as Swatch (SMI) or Helvetia, Sika, Straumann and Valiant (SMIM) have boards composed of 100% Swiss nationals. On the contrary, Transocean (SMI) has 80% of American citizens and no Swiss citizen as board members. Also Temenos has no Swiss citizen in its board.

Even though nationality may be a good criterion for diversity, it is important to emphasize the international background of the directors. We observed that 67% of directors have significant work experience abroad. This experience can favour new ideas and enrich debates.

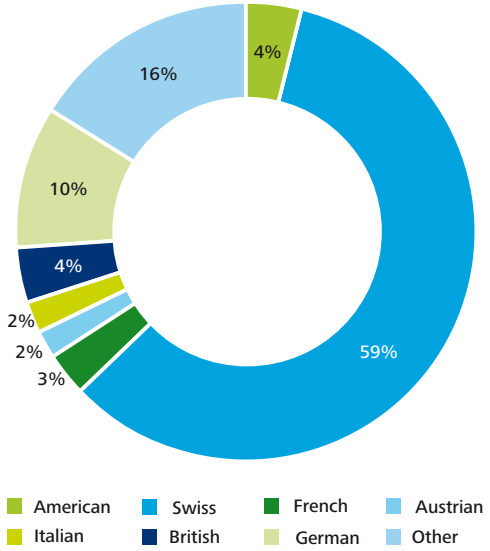
"Having a board with experienced, mature members is actually more of a positive factor."

Olivier P. Müller, CFA, Director, Manager Financial Analysis, Equity Research, Credit Suisse AG

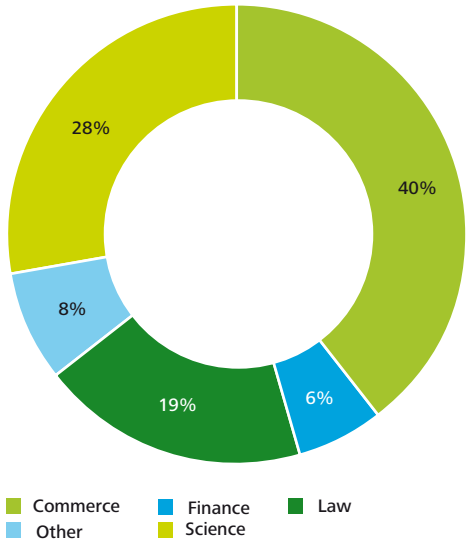
SMI nationality mix



SMIM nationality mix



Professional background



Professional experience & education: professional and educational backgrounds contribute to the personality and experience of the board members; the diversity of their backgrounds is considered as key to drive more efficiency in the board room. 60% of board members have a university degree and 37% a PhD. 40% of them have a commercial background, 27% of them have a science background and 19% a background in law.

Board members with a legal background seem to have a high representation in Switzerland. In the US, only 5% of board members have a background in law (Deloitte study, *2011 board practices report*); this might come from the former Swiss legal requirement regarding Swiss citizens when Swiss lawyers were appointed as independent non-executive directors, but also reflects the need to have a legal expert in the board.

Board members with a finance background (accounting, finance, banking) account for 6% of the panel. This ratio might seem low considering the fact that the audit committee, as per the code of best practices, should be composed of a majority of financially literate members. As a comparison, in 2011, 18% of new US directors had banking, finance or accounting credentials. This US trend seems to be driven by the Sarbanes-Oxley Act, which created a demand in candidates with financial backgrounds.

Gender: There are numerous studies performed on the level of gender diversity in the boardroom. This is discussed in more detail in the section Women in Governance.

New board members – Trends:
We selected board members elected in the past two years (94 persons) and built up a profile of the new board members.

- **Age:** New board members are younger than the average, being 56 years old (versus 61 in Swiss-listed companies).
- **Gender:** 12% were women, which is slightly higher than the average of 9% in Swiss-listed companies.
- **Nationality:** 53% of new board members are not Swiss nationals (versus 50% in SMI/SMIM companies).
- **CEO experience:** 39% had held a CEO position in the same or another company, which is lower than the average of 45% in Swiss-listed companies.
- **Position in the same company:** 12% hold or have held an executive role in the same company, which is lower than the average of 21%.

Independence and challenge

In Switzerland, there is no legal definition of independence. The Swiss Code of Best Practice provides guidance on the definition (see below). Many companies are basing their definition of independence on these recommended guidelines, although in practice they may tailor it to their situation, and therefore the definition of independence set by SMI/SMIM companies is not uniform. The Swiss Code of Best Practice's recommended definition is also so broad, that it is relatively easy for companies to state that their board members are "independent" whereas they may be, for example, ex-members of management. In reality, Swiss board members may be deemed independent whereas compared to some counterparts in Europe, they would not be classed as independent. For example, in Switzerland, a director is deemed independent if he/she has not been a member of the executive management for the last three years. In the UK and France, this figure is five years, and in Germany, not more than two former members of the management board may be members of the supervisory board.

In European neighbouring countries, independence is often defined by a corporate governance code or by law, for example in Germany. For further information, please refer to the appendix – a Comparison of Corporate Governance codes in Europe. Our review of SMI/SMIM listed companies shows that 86% of board members are declared as being independent. Furthermore, 29% of companies have a fully independent board. In Europe, 43% of board members are defined as being independent.

This may not necessarily mean that there are more independent members in Switzerland, but perhaps that the Swiss definition is broader. As mentioned above, we noted a few instances of companies giving more details in their definition of independence. For example Geberit (SMI) extends this cooling-off period to 5 years; Adecco (SMI) points out that a person having worked for their external auditor in the past three years cannot be considered to be independent; Sulzer (SMIM) seems to have the most restrictive definition of independence since none of its board members was ever part of Sulzer management or executive committee. We noted that some companies did not disclose either their definition of independence, or the number of independent board members (72% of the panel clearly discloses the number of independent members).

We also noted that on average, 9% of board members hold an executive role in the same company and 21% hold or used to hold an executive role in the same company. It was also noted that it is very common in Switzerland for the CEO to be appointed to the board on retirement.

For financial institutions, at least one-third of the board must consist of non-executive and independent directors per FINMA regulation (circular FINMA 2008/24). Among other criteria, board members are generally considered to be independent if they are not active (and were not during the past two years) in any other function for the respective entity.

Independence

The Swiss Code of Best Practice recommends: "That a majority of the members of certain committees be independent. Independent members shall mean *non-executive members of the Board of Directors who never were or were more than three years ago a member of the executive management and who have no or comparatively minor business relations with the company."*

Our review of the corporate governance reports shows that 86% of the board members are declared as being independent … In Europe, 43% of board members are defined as being independent. This may not necessarily mean that there are more independent members in Switzerland, but perhaps that the Swiss definition is broader.

*Dr DeAnne Julius is also an independent director of Deloitte LLP.

Point of view – Ethos Foundation

The independence of the board of directors is a key factor for a balanced governance

Establishing the overall strategy of a company and supervising the general management are the main tasks of the Board of directors. To achieve this, the board should consist of a majority of independent members, meaning that they are free from conflicts of interest. Independent directors bring an external perspective on the strategy and future prospects of the company and, if necessary, can challenge the proposals of the CEO and management. They can decide and act independently and objectively in the interest of the company and all its shareholders.

A board gains in strength and effectiveness when it has several independent directors. This is why most of the codes of good practice in corporate governance stress the importance of board independence in order to ensure a balanced distribution of power within a company and have for this purpose a list of independence criteria.

For Ethos, a member of the board of directors may be qualified as independent if he/she:

a. Is not an executive director or employee of the company or a group company, or has not been in the last five years.

b. Is not a major shareholder, a consultant of the company or another stakeholder (employees, suppliers, customers, public authorities, state).

c. Was not involved in the audit of the accounts of the company (as auditor or member of external auditor management) during the last five years.

d. Has no direct relationship with the founding family or with a leading member of the company or its consultants.

e. Does not have a conflicting or cross mandate (cross directorship) with another director.

f. Has no leading position in a political or non-profit organization within which the company gives or receives contributions in cash or material donations.

g. Does not receive a substantial direct or indirect remuneration from the company other than in connection with his director function, or did not receive such remuneration regularly in the last three years.

h. Does not sit in the board of directors and is not related to the company for more than twelve years (or the number of years required by the law or codes of good practice of the country).

i. Does not benefit from the same types of compensation as the executive members of the Board and senior management and does not participate in the pension plan of the company.

Engagement of the board

Given their responsibilities and the growing complexity of multinationals, board members are required to dedicate sufficient time to their board role. The review of corporate governance reports and of their curricula shows they are busy persons with many other appointments. Company directors are in demand and frequently accept multiple directorships as well as appointments with charities and non-profit organisations.

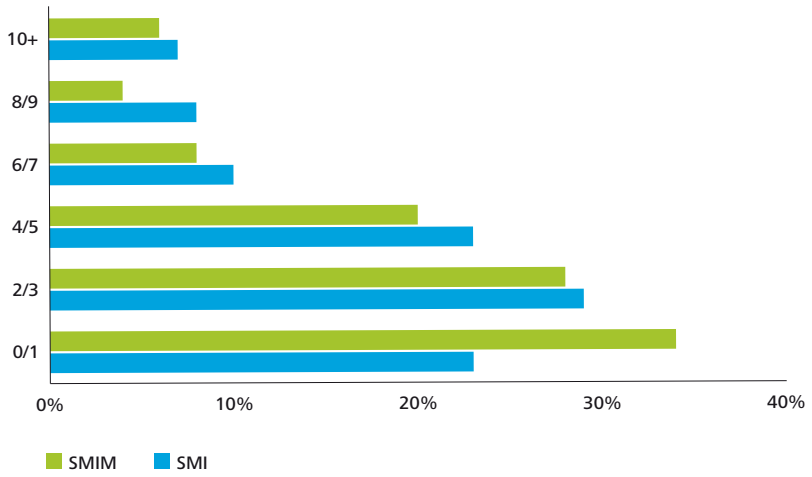
On average, SMI board members occupy 4.1 other corporate roles on top of their board function, whereas SMIM board members have on average 3.4 other corporate appointments and Chairpersons have on average 3.5 other roles.

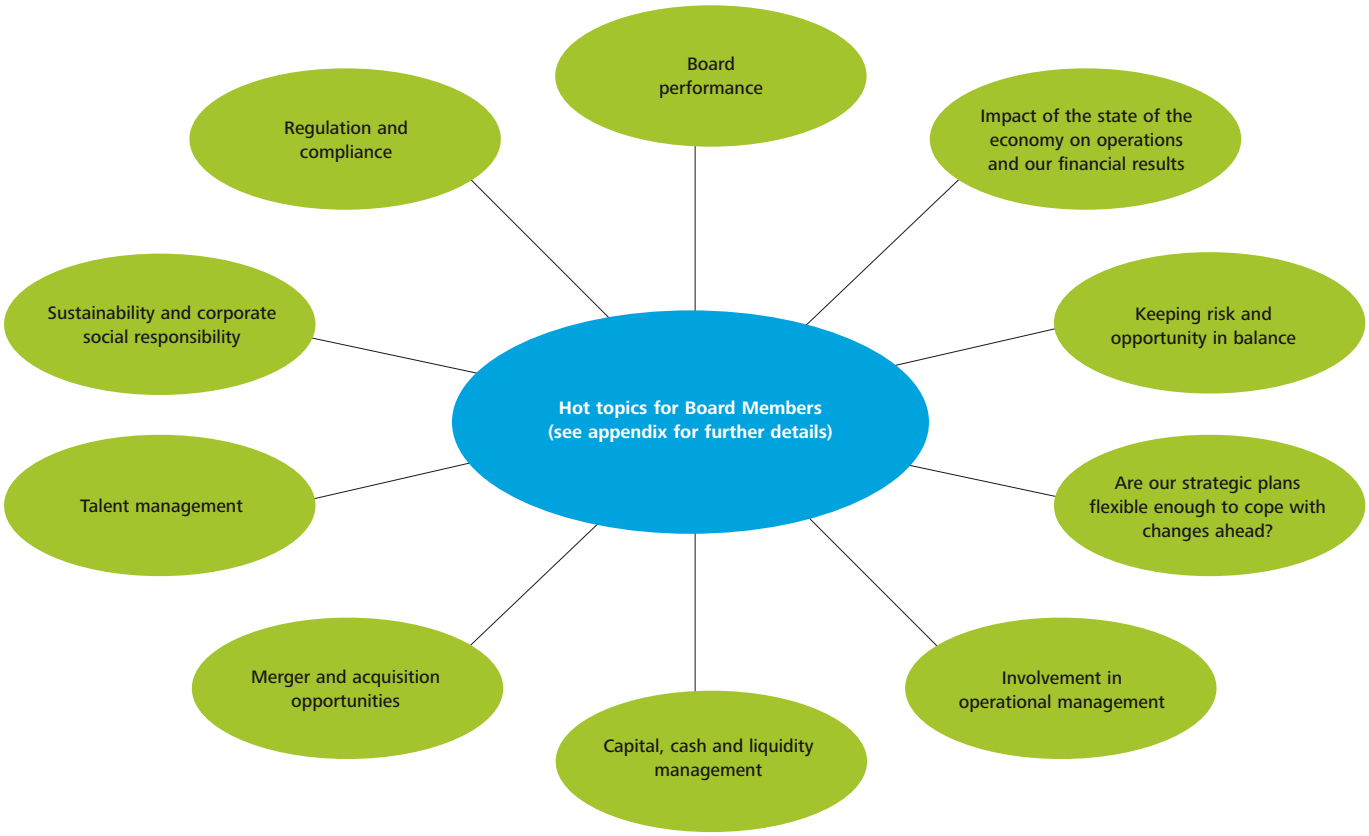
The review also shows that several cross-memberships can occur within boards of SMI and SMIM companies. We demonstrate SMI board cross-membership in the diagram to the right. Of the 400 directors holding positions in the SMI/SMIM boards, there are 31 of these directors who hold more than one directorship of a SMI/SMIM company. Of these 31 directors, 2 individuals hold 3 directorships. Nestlé (6 directors with cross-membership), Swiss Re (5), Holcim and Roche (4) are the Swiss-listed companies with the highest number of board members having cross-memberships. 15 do not have any directors with appointments on other SMI/SMIM boards.

> "Due to the significant time commitment required, 4-5 board appointments may already be equivalent to a full-time job."

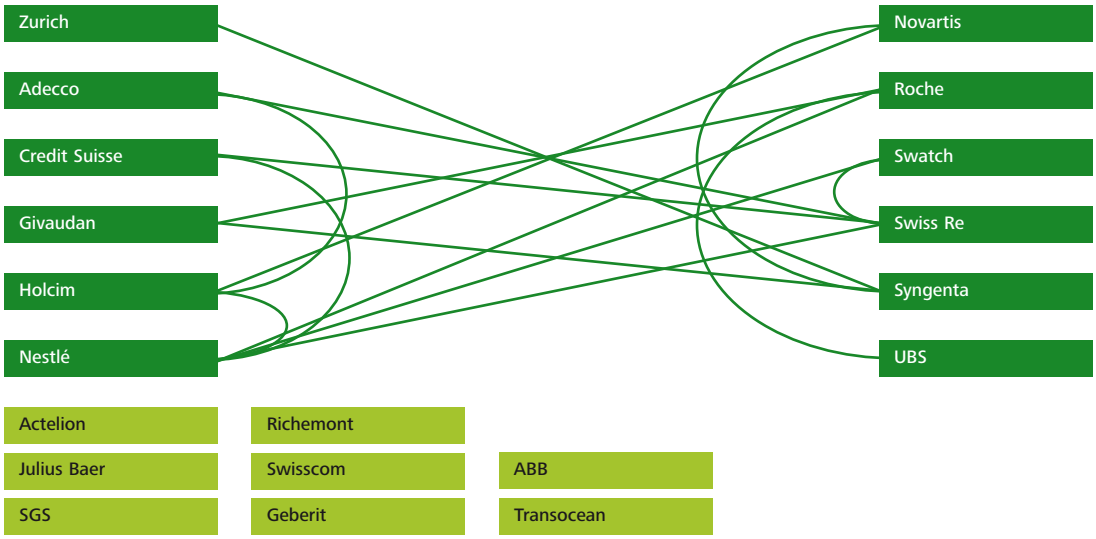
Dr DeAnne Julius, Independent board member and Roche audit committee chair

Directors' other engagements





Cross board memberships – SMI listed companies



Board meetings and attendances

Swiss boards meet on average 8 times in 2011 compared to a recommendation of at least 4 times a year and averages of 8.2 times in Europe and 9.4 in the US. One company had only 3 meetings in 2011 whilst another had 20, undoubtedly a reflection of the some of the challenges that they were facing.

The corporate governance reports often disclosed the type of meetings (daily face-to-face meeting, conference call and even multiple day seminars). Most of the reports also disclosed the length, in hours, of the meetings and whether the board members attended the meeting.

Sub-committees of the Board

Each board of directors decides upon its own internal organization and appoints subcommittees to perform specific tasks. This enhances board effectiveness as it allows for maximum value from board members' time. SMI/SMIM companies have on average between 3 to 4 subcommittees each. This is similar to the European average of 3 and the US average of 4.2.

We noted that the most common subcommittees are the audit committee (all SMI/SMIM companies have established an audit committee, refer to the audit committee section), and the remuneration and nomination committees (which are sometimes two separate committees, depending on the company). Other common subcommittees are the governance committee and the strategy committee. Beyond the above more "standard" subcommittees, Swiss companies often create committees with other clearly defined tasks: 30% of the Swiss-listed companies created ad-hoc committees.

In general, subcommittees have 3 to 5 members, the nomination committee being the subcommittee with the most representation (5, mainly driven by Richemont and Swisscom nomination committees where 14 and 9 members sit, respectively). Chairmen of the full board are on average members of at least 2 subcommittees and chair these subcommittees in 58% of the cases.

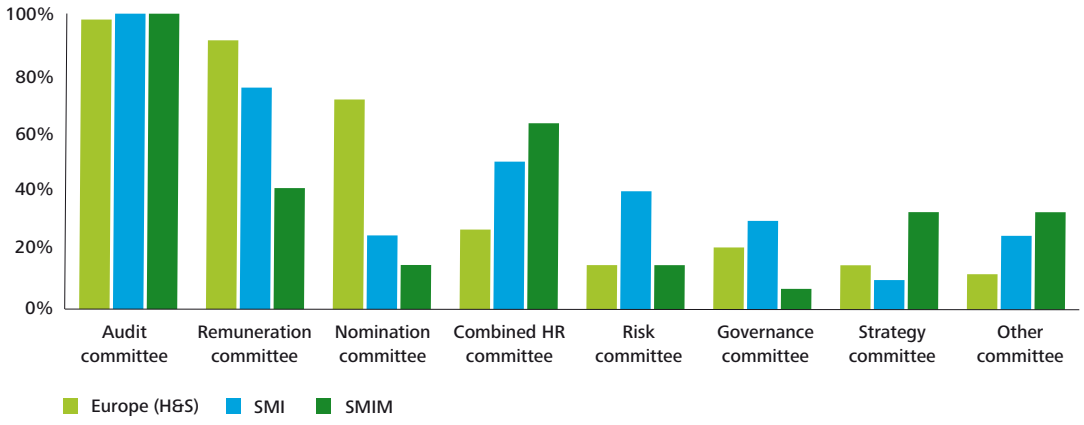
In 2011, financial institutions held more meetings than companies from other sectors. For instance, UBS and Swiss Re held 38 subcommittee meetings in 2011, and Crédit Suisse held 34. On average, SMI/SMIM entities held 17 subcommittees meetings in 2011. Financial institutions are subject to additional governance and regulatory control by the Swiss Financial Market Supervisory Authority (FINMA) which perhaps leads to the need for more committees and meetings, as well as ad-hoc issues banks faced in the last years.

On the other hand, Swatch Group and Pargesa held only 3 subcommittees meetings, Geberit 4, PSP 5 and SGS 6.

Eight SMI companies reported having a board risk committee. This included all five financial sector companies plus Novartis, Transocean and Swisscom. FINMA does not specifically require banks and financial institutions to have a risk committee, whereas banks of a certain size must have an audit committee (circular 2008/24).

Compensation/remuneration and nomination committees are frequently established to perform tasks such as setting the company remuneration policy and preparing for the future board members succession or election. These two committees can exist separately, or be combined in a single committee. We also noted that some companies have a "nomination and governance committee" or a "governance, compensation and nomination committee". Taking into account separate and combined committees, all Swiss SMI/SMIM companies have integrated this type of committee into their board organization. Compensation committees, nomination committees or combined committees have on average 4 meetings per year, with slight differences between SMI and SMIM companies.

Prevalence of board committees



The financial analysts' point of view

"We do look at corporate governance, but it is rarely taken into consideration for valuation as it is highly qualitative and unquantifiable. In terms of corporate governance, we do look out for those factors that really stand out, so-called "red flags", which may include a combined CEO/chair role, having members of management on the board, or a lack of independent members... Factors we primarily look at include company's growth, profitability and efficiency. Bad governance and management will have ultimately a negative impact on all of those."

Olivier P. Müller, CFA
Director, Manager Financial Analysis, Equity Research, Credit Suisse AG

The rating agency's point of view

"Corporate governance from a ratings perspective is highly qualitative and it has to be evaluated on a case by case basis. There are four key areas we look at in particular:

- Board effectiveness – for example, how strong is the board, do they have a succession plan, how are they overseeing management.
- Management effectiveness – what is management's approach to risk, what is their risk appetite?
- Issues and specific factors – details such as are their financial statements issued timely, what does their audit report say, do they provide interim statements, how are their internal controls.
- Related party transactions – a high level of related party transactions could indicate a higher level of risk, and could influence the rating.

To sum it up, good corporate governance is generally expected. However, bad corporate governance can impact ratings negatively."

Responsible for Corporate Governance, a global ratings agency

The role of the board is to manage performance as well as governance. These two complementary areas may be dealt with by the governance committee and the strategy committee (even though strategy may also be a topic for the full board meeting). The corporate governance reports tend to show that these two committees, when they exist, have regular meetings during the year (average of 9 times for governance committees and 6 times for strategy committees).

A recent study by Deloitte US, *Director 360*, shows that board members are currently spending more time on compliance and supervision, and less time taken on performance, probably as a result of the economic downturn and increased regulatory pressure. Our review shows that this is happening also for Swiss firms with the establishment of a governance committee.

A review of the corporate governance reports shows that the governance committee, also called "chairman and governance committee" by Swiss Life, Swiss Re and Crédit Suisse, may combine varying roles such as i) being in charge of compliance with corporate governance principles (e.g. independence of the board members) or ii) assisting the chairman in the decision-taking process. Nestlé describes this subcommittee as a "consultant body to the chairman". These tasks tend to be handled within the combined nomination/compensation/governance committee (within the "combined HR committee" category in the chart) for 8 entities (17% of our panel).

In 2011, 25% of SMI companies and 33% of SMIM companies had non-standard committees. These can be specific committees created to respond to a continuous sector-specific challenge, or committees created in response to an ad-hoc issue. This practice exists in both SMI and SMIM companies. We also observed safety/environmental-focused committees (Health safety and environment committee at Transocean), technology-driven committees (Technology and innovation committee at Clariant, Nobel Biocare and Lonza), fraud/bribery dedicated committees (Professional conduct committee at SGS), investment committees (Swiss Prime, Swiss Re, Baloise and Helvetia). Meyer Burger has two specific subcommittees: merger and acquisition committee and construction committee. UBS has created a "special committee" following the trading issue in its London office.

Corporate Governance online

All companies on the SMI and SMIM except one have a separate Corporate Governance section on its website. This usually consists of an overview of the following key topics:

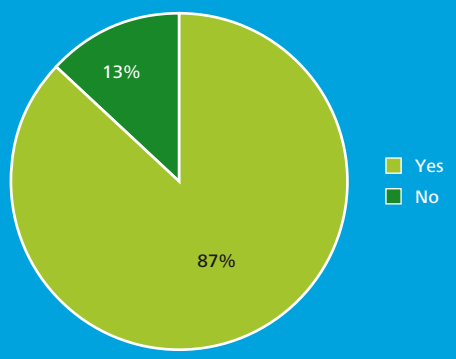
- Capital structure
- Group structure & shareholders
- Compensation policies
- Management and Board biographies
- Committees
- Code of conduct

Several companies provide the mandatory Corporate Governance report available to download separately from the Annual Report.

For example Syngenta has a separate Corporate Governance and Compensation Report which covers the topics above as well as management remuneration policies.

Nestle publishes an update to its Corporate Governance report at half year to describe any changes that have been made since the annual mandatory report.

Does the company have a board charter on its website?



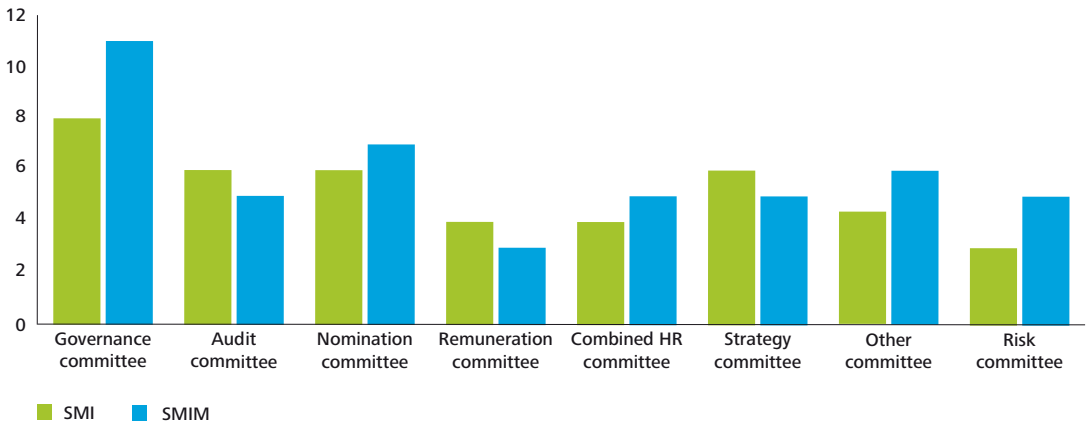
Almost all of the companies surveyed publish either a board charter or the Articles of Association online.

For example, Roche publishes its Articles of incorporation and Company bylaws on its website. This allows users to understand in detail the roles and responsibilities of the Board of Directors. It also publishes details on its Board of Directors, Board Committees, AGM and its group code of conduct.

The UBS website includes information on the Board, the Group as well as publishing its code of conduct, independence criteria and company regulations.

25% of SMI companies and 33% of SMIM companies had non-standard committees. These can be specific committees created to respond to a continuous sector-specific challenge, or committees created in response to an ad-hoc issue.

Average number of subcommittee meetings



Frequency statistics:

- Full board meetings take place 9 times per year in SMI companies and 7 times in SMIM companies.
- SMI companies have on average 4 subcommittees, whereas SMIM companies have 3 subcommittees. The most common subcommittee is the audit committee (all SMI/SMIM companies).
- Subcommittees meet on average 5 times per year; all subcommittees met in total 17 times by company in 2011, on top of the regular board meetings. On this topic, there is no difference between SMI and SMIM companies.

The Chairperson of a SMI/SMIM company

- Male in all but one case.
- Average age is 61 years old.
- 43% of the current chairpersons are or have been CEO of the same company.
- 70% of the current chairpersons hold or have held an executive role in the same company.
- 2 SMI companies and 4 SMIM companies combine the role of chairperson and CEO.

Chairperson

The role of the chairperson is, above all, the key determinant of whether a board is effective. The role is important as the boardroom's dynamics can be challenging and very different from those normally associated with an executive committee. Generally influence and authority should be shared within a board and decisions made based on a consensus.

The average chairperson is a male of 61 years old, already having held an executive and even CEO experience in the same company. 62% are Swiss nationals. We do not notice major differences between SMI and SMIM companies.

In 2011, 6 companies combined the role of chairman and CEO. Richemont was already in our sample last year (SMI); Geberit's chairman, which moved from SMIM to SMI following the Synthes delisting, also combines these 2 roles. 4 SMIM companies, Lindt, Galenica, Gam and Logitech are under this one-tiered/combined Chair/CEO model. The EU Green Paper on corporate governance pointed out last year the risk of having the same person as CEO and Chairman and evoked the necessity to ensure a clear separation of powers. The Swiss Code of Best Practice recommends in case of joint power situations to put control mechanisms in place. The combination of CEO and chairman roles is seen by Lindt (SMIM) as a facilitator of the communication between the board and the management or as leadership continuity. However, Lindt implemented a control mechanism by creating a Lead Director whose role is to safeguard the independence of the board of directors in relation to this combination (with the authority to convene and chair a meeting of the Board of directors himself which will not be attended by the Chairman and CEO). Logitech mentions that the situation of having a same CEO and chairman is temporary.

Putting the above into perspective, the combination of the CEO and chairperson role is relatively uncommon in Switzerland compared to other countries like the US where in 2011, 59% of the CEOs were also Chairmen (as per a Spencer Stuart study, *2011 Spencer Stuart board index*).

Differences and similarities between SMI and SMIM companies:

- **Number of board members:** the average SMI board of directors consists of 11 members, whereas the average SMIM board of directors consists of 9 members.
- **Length of board service:** the average length of service is of 6 years for SMI board members and 7 years for SMIM board members.
- **Average age of board members:** SMIM board members appear to be slightly younger (58 years in average) than SMI board members (60 years).
- **Diversity of the board:** SMI boards, with 59% of foreign directors, tend to be more international than SMIM boards, with 41% of foreign directors. SMI and SMIM board members have similar educational backgrounds and we did not identify major differences in the professional background of the board members.
- **Engagement:** in average, SMI board members occupy 4.1 other corporate roles on top of their board function, when SMIM board members have 3.4 other corporate roles. Chairmen have on average 3.5 other appointments.
- **Board meetings:** SMI companies' board of directors have on average 9 meetings per year, where SMIM companies have a meeting frequency of 7 times per year.
- **Subcommittees:** SMI companies have on average 4 subcommittees, SMIM only 3; SMI companies organize more subcommittees meetings during the year (10 vs 17).
- **Chairperson:** The chairperson's role and the level of skills and investment will vary greatly according to the size, risks and global nature of the operations. In spite of this, we did not notice any obvious differences in the profile of chairpersons between SMI and SMIM companies. Nevertheless, there are slightly more combined CEO/chairperson roles in the SMIM compared to the SMI (15% vs 10%), and SMI chairmen are more likely to have held the CEO position in the same company than their SMIM counterparts (45% vs 30%).

We expect this situation to develop further in Switzerland with more firms following best practice. Take for example Galenica: the Galenica chairman/CEO resigned from his CEO position as of January 1, 2012 to implement a clear separation of the functions of CEO and chairman. Compared to 2005 when there were 6 SMI companies with a combined CEO/Chairperson, there are now only 2 companies in 2011, as described in the previous paragraph. Furthermore, at the date of our analysis there were also three chairmen who hold two chairman positions in SMI and SMIM companies (Adecco – Swiss Life, Holcim – Lonza and Givaudan – Clariant). We see more Chairmen focusing on only one or two companies due to the level of commitment necessary for these pivotal roles.

Looking ahead – future developments

Independence: trends towards a higher proportion of independent board members remain a target in Switzerland as in many countries. Having a healthy mix of independent members as well as former members of management with their in-depth understanding of the business creates an optimal board composition.

Succession planning: planning for future members of the board and executive committee should be high on the priority of the board and its chairperson. Trends towards ensuring a diverse mix of backgrounds and skills is becoming a priority, and also bearing in mind the worldwide trend towards more gender diversity.

Board evaluation: as discussed in the section on board performance evaluation (page 33), there continues to be limited disclosure on this topic in the annual report or website. Based on disclosed information, compared to best practice, SMI and SMIM companies appear to be lagging behind some of their counterparts in Europe and the US.

Limits on board assignments: As noted above, some non-executive directors may have more than ten other appointments, and several are board members on several public companies. As the role of director is an increasingly demanding one, it is important that the evaluation of performance also considers the amount of time spent on the role and whether commitment to other roles in still manageable. Do members spend sufficient time to discharge their responsibilities effectively?

Communication, technology and confidentiality

As technology advances, an increasing number of companies are moving towards faster and more practical means of communicating and we are seeing more and more electronic communication between the board, management and the auditors. For example, many companies are moving away from heavy paper board packs, many now choosing a virtual board pack that can be consulted on directors' iPads using tailor-made Apps. In the US for example, per a recent Deloitte survey, 20% of companies surveyed are using an iPad application or other tablet device, and 79% state that their board's use of technology is increasing. As board members may hold several board appointments in several countries they are frequently travelling, e-mail communication and board portals are tools that make it easier to consult and analyse company operational and financial information. Boards are entering into new era of heightened accessibility and efficiency – subject to the appropriate safeguards against breach of confidentiality, such as using a secured means of communication (company intranet) or encrypting data. This is particularly important in black-out periods. Do directors know what to do if they lose their e-packs? The best prepared board members know what to do and who to call in such an emergency.

Deloitte Audit Committee Resources iPad app launched

Now you can readily access the *Audit Committee Brief* through an easy-to-use iPad app. Deloitte's new Audit Committee Resources application is available in the iTunes App Store. New issues of the brief are available for download each month and feature useful multimedia content not available in the print version. The application also includes an interactive edition of the popular *Audit Committee Resource Guide*.

Click here or visit the App Store and search for "Deloitte Audit Committee Resources" to download the application.

Deloitte.

"The ultimate benchmark for any leader is what he leaves behind. Succession planning is one of my top priorities. For management we have a formal process integrated into our talent management. The aim is to groom 2 or 3 potential successors for each role, with the aim to prepare the future leadership team that will be able to successfully drive the business forward. Board succession is under my direct responsibility. Relevant experience, independence, team play and diversity are key criteria."

Dr Jürg Witmer, Chairman of Givaudan, Vice-Chairman of Syngenta

Women in governance

- In the EU, women represent 12% of the board members on average. In Switzerland, women represent 11% of board members of the 20 SMI companies and 7% of the board members of the 30 SMIM companies; in total, 9% of SMI/SMIM companies are women.
- 16 out of 47 of SMI/SMIM companies have no female directors (34% of all companies).
- Of the 94 new board members appointed in SMI/SMIM companies in the last year, only 11 of these appointments have been female directors (12%).
- Companies headquartered in Suisse Romande currently have more female representation on the board.

The data regarding women's representation in the board room in Switzerland shows women are underrepresented in this decision-making role compared to men. Only 9% of board members of SMI/SMIM companies are women, with 34% of companies having no female representation. There are 23 female board members in SMI companies compared to 17 in SMIM companies.

Half the graduates from high education are women, nearly half the workforce are women including in Government (three of seven members of the Swiss Federal Council for instance) and yet less than one in ten board members are women. Over a third of the companies have no females on the board at all. Not surprisingly the SMI are better placed than the SMIM but the numbers are still low compared to other countries.

It has been argued that an increase in female representation on the board results in enhanced decision making and improved company performance. As many companies are considering these benefits, the question that is on the minds of many is how an increase in gender diversity in the boardroom can be achieved.

It has been argued that an increase in female representation on the board results in enhanced decision making and improved company performance.

Women in the boardroom

The chair of the Swatch group is currently the only female chairwoman of all the SMI/SMIM companies: this means only one in the 47 largest Swiss companies.

There are many companies in Switzerland with no female representation on the board; 34% of the SMI/SMIM companies have no women on the board. In comparison, only 25% of all EU companies have no female representation. Denmark, Finland and Sweden are the countries with the lowest number of companies that have no female board representation (0%, 4% and 4% respectively). Italy has the largest percentage of companies with no female representation (70%), however this percentage will decrease in the coming years as a gender quota was introduced in 2011.

"In a board of 10-12 members, 3 women is in my view the "magic" number to change the culture of the board."

Dr DeAnne Julius, Independent board member and Roche audit committee chair

… of the 94 SMI/SMIM board members newly appointed in the last two years, only 11 are women (12%). This percentage is surprisingly low. At this rate, a more balanced male-female diversity will not be achievable in the near future unless there is a real step change.

The majority of female board members are Swiss (46%), followed by Americans representing 17% of female board members. The percentage of male board members that are Swiss is 51%.

The average age of a female board member in Switzerland is 55; ranging from 34 (Pargesa) to 76 (Swatch Group). This is slightly younger than the average age of male board members in Switzerland at 60 years. 93% of the female directors have a university background and 27% of these women hold a PhD.

Nestlé and the Swatch Group have the highest percentage of women directors in the SMI/SMIM group. The Swatch Group has 2 female board members in 2011 (33%) and Nestlé has 4 female board members (27%). We also note a disparity between the SMI and SMIM indices in terms of their female representation: 11% of the board members of SMI companies are female compared to only 7% of SMIM companies.

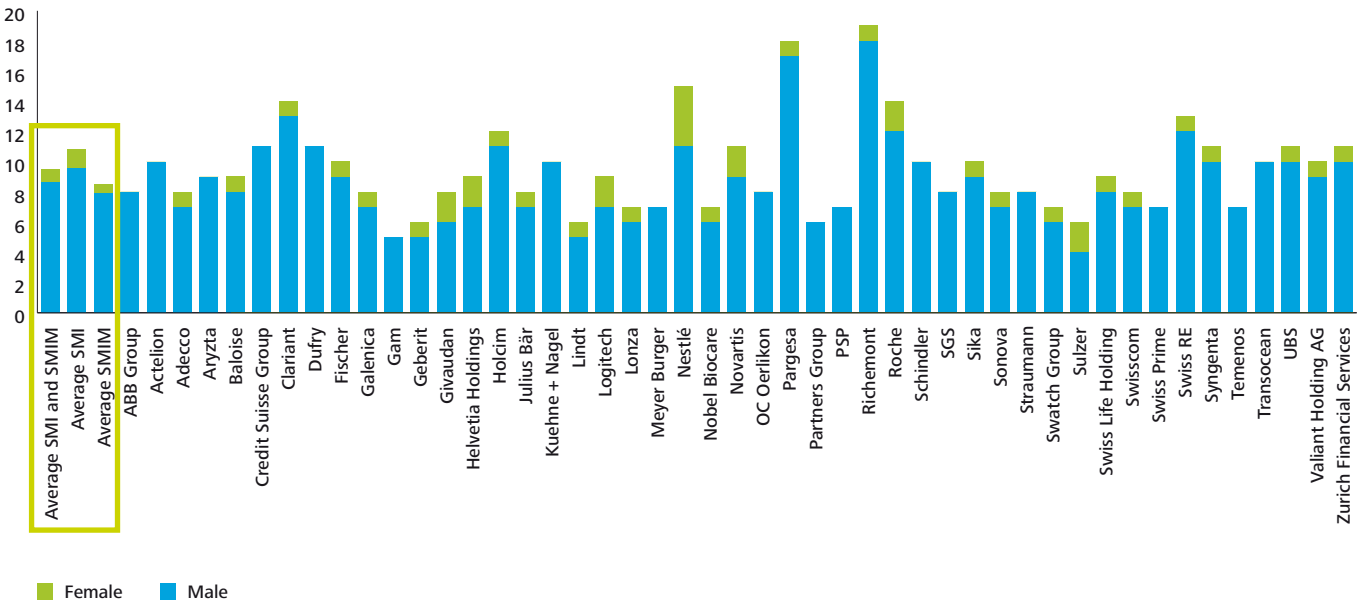
Of the 94 SMI/SMIM board members newly appointed in the last two years, only 11 are women (12%). This percentage is surprisingly low. At this rate, a more balanced male-female diversity will not be achievable in the near future unless there is a real step change.

We have determined that 39 of the SMI and SMIM (82%) companies have their headquarters in the German region of Switzerland, while the remaining 8 (17%) are based in Suisse Romande. Of the 40 female directors, we have calculated that 30 of them (75%) work in the German region while 10 of them (25%) work in the Suisse Romande. Companies headquartered in the Suisse Romande currently have a higher level of female presence on the board.

A Swiss SMI/SMIM female board member

- Average age of 55
- 46% of female board member are Swiss
- 93% hold a university degree
- Average length of service is 5 years
- 17% have a CEO background

Number of members per company



Are quotas the solution?

Although 45% of the working population in the European Union are women, they only represent 13.7% of board seats in the EU's largest companies.[1] A growing trend in the EU is the implementation of quotas to increase the number of women representation in the board. In the last couple of years,[2] Italy, Belgium, the Netherlands, and France have all passed legislation mandating a certain percentage of female board members. The table below broadly summarises the situation towards the end of 2011:

Country	Quota	% of women serving on listed companies[4]
Australia	No mandatory quota however disclosure requirements and adoption of a diversity policy is required since 1 January 2011	12.5
Belgium	Yes – one third of "less represented" gender	7.7
Canada	No	12.9
China	No	8.1
France	Yes – 20% by 2014, 40% by 2017	20.8 (CAC 40)
Germany	No	8.2
Hong Kong	No	8.6
India	No	5.3
Italy	Yes – one third of "less represented" gender	3.7
The Netherlands	Yes – not compulsory – "comply or explain" – quota of least 30% of each gender, discretion of the remaining 40%	9.2
Malaysia	Yes – 30% by 2016	7.8
New Zealand	No	12.0
Norway	Yes – since 2005 – quota depends on size of the board of directors	31.9
Singapore	No	6.4
Spain	Yes – since 2007 – quota of 40% of women by 2015	9.2[4]
Switzerland	No	9.2 (SMI/SMIM)
United Kingdom	No	12.5 (FTSE 100)
USA	No	15.7

There are currently no gender quotas in Switzerland, and there are no plans to introduce this.

Although the introduction of quotas has shown to be a useful tool to increase female board representation, it is not always popular in public opinion. In 2011, the European Commission produced a Green Paper on the Corporate Governance Framework[3]. In response to this publication, a feedback statement on responses to this paper was published. Respondents were asked if companies should be required to ensure a better gender balance on boards. Most of the respondents asked were opposed to the introduction of a quota system to increase the percentage of female representation on boards.

It was also noted the reason for this rejection of a quota system or other mandatory requirements, was that it would be considered an intrusion of shareholder rights.[4]

Although the introduction of quotas has shown to be a useful tool to increase female board representation, it is not always popular in public opinion.

1 EC Women in economic decision-marking in the EU: Progress Report Luxembourg 5.3.2012
2 Deloitte: Women in the Boardroom 11.2011
3 EC Green Paper on Corporate Governance Brussels 5.4.2011
4 EC Feedback Statement: Summary of Responses to the Commission Green Paper on Corporate Governance Brussels 15.11.11

"...legislation measures are viewed by many as controversial and tend to polarize opinions [...]. The counter argument runs that without stimulating measures, progressing towards more balanced board participation between the sexes is happening at an unacceptably slow pace."

Liselott Kilaas, Managing Director of Aleris AS in Norway and Denmark

Point of view – economiesuisse

economiesuisse supports diversity in the board of directors. Beside the right mix of talents, skills and experience diversity also includes the right mix of men and women. However, economiesuisse strongly declines quotas fixed by law and promotes voluntary measures. These are more flexible and are a more pragmatic way to address the underlying reasons preventing more women from being appointed into boards. They also allow for more space to respect sector and company specific circumstances.

The need for board diversity, including but not limited to gender, seems to be taking hold in boardrooms around the world in order to provide a variety of perspectives in decision-making environments.

The backlash against the use of quotas has been debated by both men and women. Some feel that better candidates for a position are not accepted due to the requirement for additional female board members. Women have also opposed these quotas with the argument that they should be appointed on merit rather than based on gender. Liselott Kilaas, Managing Director of Aleris AS in Norway and Denmark remarked in the Deloitte Women in the Boardroom: A Global Perspective[5] report that "legislation measures are viewed by many as controversial and tend to polarize opinions [...]. The counter argument runs that without stimulating measures, progressing towards more balanced board participation between the sexes is happening at an unacceptably slow pace."

Although Norway is now considered the prime example of female diversity in the boardroom, this has not always been the case. The law began to be discussed throughout Norway in 2002. Prior to 2002, women accounted for only 2 – 4% of board members[5]. The bill was originally introduced in parliament in 2003 and was finalized in 2005. However, the country had until 1 January 2008 to introduce these quotas. The percentage of women on boards gradually increased over this timeframe rising to 9% in 2004, 18% in 2006 and finally to over 40% in 2009.

In addition to quotas, a variety of non-binding measures have also been introduced by EU member countries. For example, in the Netherlands, companies can voluntarily sign a charter which requires them to establish quantitative goals for representation of women in senior management and report annually on their results. The United Kingdom has also introduced voluntary measures for increasing female board representation with the government encouraging FTSE 300 companies to set goals for the percentage of women board members by 2013 and 2015.

Looking Ahead: Future Developments

The EC position paper on Women in economic decision-making roles in the EU released in 2012 discusses the economic relevance of increase women's representation on boards. It notes improved company performance and enhanced quality of decision-making in companies with greater gender diversity on their boards. The need for board diversity, including but not limited to gender, seems to be taking hold in boardrooms around the world in order to provide a variety of perspectives in decision-making environments.

In Switzerland, a means to increasing female board representation has not yet been established. However, the momentum outside the country is shifting to using either mandatory or voluntary requirements to increase women's representation in the board room.

5 Freidrich Ebert Stiftung: Storvik and Teigen. "Women on the Board: The Norwegian Experience" 06.2010

The audit committee

In recent years the audit committee has become one of the main pillars of the corporate governance system in Swiss public companies. All SMI and SMIM listed companies have an audit committee. This is quite a recent development in Switzerland, possibly a result of a desire for increased professionalism and accountability in a decade of financial scandals and turbulent markets. As recent as ten years ago, audit committees were much rarer in Switzerland compared to its neighbouring countries.

The audit committee is created with the aim of enhancing confidence in the integrity of an organisation's processes and procedures relating to internal control and corporate reporting. Boards rely on audit committees to, among other things, review financial reporting and to appoint and provide oversight of the work of the internal and external auditor. Audit committees can also play a key role in providing oversight of risk management.

The audit committee does not have any separate legal power and the board of directors remains ultimately responsible for all decisions taken. According to best practice, the audit committee makes recommendations to the Board of directors. It is therefore a responsibility of the Board of directors to supervise and evaluate the audit committee and ensure that its members have the necessary skills, background and qualifications to be able to assist the Board in its duties.

Legal context in Switzerland

There are no references to the audit committee in Swiss law, however, guidance has been developed over the past decade. While there is no specific reference to the audit committee in the Directive on Corporate Governance, the directive does require disclosures on the various "committees of the Board of directors". This makes disclosure around the audit committee members, as well as tasks, areas of responsibility and work methods compulsory for all Swiss public companies.

The Swiss Code of Best Practice for Corporate Governance states that the Board of directors "should form committees to perform defined tasks" and specifically in relation to the audit committee "The Board of directors should set up an Audit Committee" which should "form an independent judgement of the quality of the external auditors, the internal control system and the annual financial statements".

While not compulsory for private companies, many companies have instigated an audit committee as a form of best practice in good governance, and delegate certain of the more "technical" tasks of the board of directors.

While the audit committee is not compulsory for all banks, FINMA does require for banks and financial institution of a certain size to set up an audit committee (2008/24).

"As an audit committee member it is critical for me that the external auditor will raise and discuss the issues not only with management but also with the audit committee. There should be no item hidden to the members of the audit committee."

Andreas von Planta, independent board member Holcim and Novartis

In a recent discussion paper[1] by the Federation of European Accountants (FEE), it was recommended that the responsibility of the audit committee vis-à-vis the board and other board committees be clarified. In some countries, some decision-making power is delegated to the audit committee.

1 FEE discussion paper: The functioning of Audit Committees (June 2012)

Tasks and responsibilities

There is no predefined list of tasks and duties of the audit committee (other than those suggested by the Swiss Code of Best Practice on Corporate Governance). The Board of directors is relatively free to choose which areas it wishes to delegate to the audit committee to oversee and monitor. Several companies may choose to draw up an Audit Committee Charter which sets out the statement of purpose, the organisational rules and its responsibilities. Many companies publish their charters on their company website.

In the table below, we see the variety of responsibilities of the audit committee in terms of the various monitoring and oversight duties delegated to them by the board of directors.

Are audit committee members more exposed?

Legal viewpoint: The audit committee is an advisory body. The authority to make final decisions remains under the competence of the board of directors as a whole (art. 716a para. 2 CO). The duties of the audit committee are in principal part of the "non-transferable and inalienable duties" of the board of directors (art. 716 a SCO) and, thus, cannot be delegated.

In real life however, the board may more or less delegate full responsibility for financial reporting and risk management to the audit committee. Does this heighten their liability in the case of a problem or error? Is there a false expectation that the audit committee will catch all the risks?

Risk management – audit committees often support the Board in the area of risk management and mitigation. This may be limited to financial risks (key judgements, impairment, post acquisition risks etc.) or also including operational, technical or reputational risk. In some companies, a separate risk committee may be set up (See section on risk committees). This topic is discussed further in the risk oversight section.

Transparency in working methods

The audit committee (also called the "financial, audit and compliance committee", the "audit and compliance" and "risk and audit committee"), meets between 1 (Swatch) and 11 (SwissRe) times during the year (SMIM 2 to 7 times) with an average number of between 5 and 6 meetings. However, the large majority of audit committees usually meet 3 or 4 times annually. Meetings are disclosed as lasting around 3 to 4 hours, but can last up to 2 whole days (Schindler). Note that some companies did not disclose the length of the meetings.

There is little external visibility in Switzerland over the work and conclusions of the audit committee and recommendations to the board of directors. This is partially due to confidentiality but also lack of detailed disclosure requirements in Switzerland. In the US for example, the audit committee report, as a component of the proxy statement, is required for public companies. The report is a key mechanism to communicate to investors the critical activities the committee performs related to financial reporting oversight. The audit committee report often goes beyond the minimum required disclosures to communicate, and take credit for, the activities the audit committee performs throughout the year. In the UK, there are also plans to introduce a requirement for the audit committee to report to the full board on how it has discharged its duties.

Interaction with internal audit

One of the main tasks of the audit committee is the oversight (direction, guidance and monitoring) of the internal audit function. An effective relationship between the audit committee and the internal auditors is fundamental to the success of the internal audit function. The audit committee monitors the internal audit function's resources and skills, and approves the audit plan, which is usually based on a risk analysis. It has become increasingly important for audit committees to assess whether the internal auditors are monitoring critical controls and assessing and addressing emerging risks. Internal audit and external audit work together in various ways, from regular meetings to update on each other's work plan, debrief on internal controls testing (which is often delegated to internal audit) or in some cases, part of the external audit plan will be delegated to internal auditors. It reviews the internal audit reports, ensuring that action points and recommendations are followed in a prompt and serious manner.

Relationship and oversight of the external audit mandate

The audit committee oversees the mandate of the external audit firm and in particular discusses the audit plan and scope, audit findings and issues arising during the audit, as well as reviewing the overall service provided and the level of fees. It is often the audit committee that initiates the audit tender process.

In Switzerland the level of scrutiny of audit firms has been reinforced over the last years with the introduction of a new law to oversee the auditor (AOA) as well as the creation of a federal audit oversight authority oversight body (FAOA). In addition, the mandatory rotation of the lead auditor in charge every seven years was introduced into the Swiss Code of Obligations (730a CO). This rule refers to the audit partner rather than the audit firm. In reality, this change did not bring significant change for Big four firms which were already applying stricter global independence policies.

Only two SMI/SMIM companies have changed audit firms in the last five years.

The Internal Control system

The audit committee often helps to oversee and monitor management's assessment of internal control over financial reporting.
In Switzerland, since 2008, the external auditor confirms the existence of an internal control system (ICS) which has been designed and approved by the board of directors and generally implemented by management. The internal auditor is often mandated to test the design and implementation of the ICS. While the Swiss ICS is less arduous than the US Sarbanes Oxley requirement, it is often a time-consuming element of the audit committee's remit.

"Even if the audit committee (as for all other committees) is set up to deal with certain matters and that ultimate decision-making remains with all members of the Board of directors, in practice there is an increasing tendency to believe that the non-members of the audit committee may have a lesser responsibility compared to the members of the audit committee."

Mr Christian Budry, Independent board member Romande Energie & Publigroupe, audit committee chairman

We observe very little rotation in the audit firms of SMI/SMIM companies, for which the audit market is significantly dominated by big four firms. Only two SMI/SMIM companies have changed audit firm in the last five years which is an indication that audit firm rotation is law in Switzerland and many companies have had the same audit firm for decades. Due to frequent mergers and name changes of audit firms, it is difficult to collate accurate data from public information.

EC legislative proposed changes to audit regulations
Published in November 2011, proposed changes include new requirements for the audit of public interest entities (PIEs) across the EU. Measures include mandatory audit firm rotation, more transparency in the audit tendering process as well as greater restriction of non-audit services and audit-related services. Furthermore, there are heightened rules for the PIEs' audit committee members in terms of independence (e.g. composition of exclusively non-executive members) and audit/accounting competencies as well as expertise in the PIE's specific industry sector.

There are also proposals for mandatory long-form reports to the audit committee as well as an extended audit opinion to coveran assessment of the internal control system and compulsory compliance with International Standards on Auditing. If the new legislation comes into force, then member states would have to transpose legislation into national law and the new rules could be effective around 2014.

In September 2012, however, several of the proposed changes of the audit reform were amended to effectively dilute their impact, for example the proposal rotation of auditors was revised from six years to 25 years in the new text.

For more information, see www.corpgov.deloitte.com/site/uk

External auditor communication to the audit committee

The external auditor is usually present at most audit committee meetings during the year, and as a minimum to present the proposed audit plan and final audit report at the conclusion of the audit. The level and sophistication of reporting may vary according to current or best practice of each audit firm as well as the requirements of each audit committee. Swiss auditing standard AS260 (Communication with those charged with governance) outlines the requirements for reporting to the audit committee or to those charged with governance. Swiss law requires the auditor to prepare a comprehensive report to the board of directors (article 728b) outlining the audit plan, results and conclusions, and a checklist for listed companies was issued by the Oversight body in 2009. The reporting to the audit committee usually follows the content of this report but the level of detail may vary. The EC proposed long-form report mentioned above is along the lines of the current Swiss practice.

PCAOB proposes a reinforcement of auditor communication with the audit committee
In December 2011, the US oversight body for listed companies (PCAOB) re-proposed an auditing standard that seeks to improve and harmonise the way the external auditor reports to the audit committee. While many audit firms may already be applying the required levels of communication, the PCAOB seeks to ensure that communications are consistent throughout the profession.

Audit committee composition and its chair

The SMI/SMIM audit committee has between 2 and 6 members (smallest: Schindler, largest: Swatch). There is no minimum requirement in Switzerland for the number of members, whereas in 12 European countries there is a minimum requirement for at least 3 members[2]. In some countries an employee representative may be required by law.

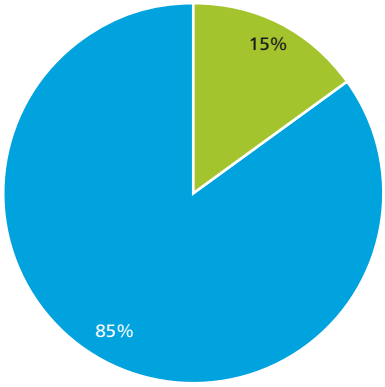
With audit committees under increased scrutiny and the ever-changing regulatory landscape, the audit committee should be as diverse as possible in terms of competencies, background and experience. It is the duty of the Board of directors to continuously ensure that its audit committee includes the right array of skills and experience. Companies and their shareholders rely on audit committee members' judgement to oversee areas such as risk, compliance and financial reporting.

The typical audit committee member has several other appointments or functions, such as a non-executive director of other companies, a member of another audit committee, or sitting on a university advisory board. Very few audit committee members have full time executive functions, as the non-executive role is very time consuming and, in practice, most members have retired from executive roles. There are of course exceptions, as there are currently 15% of audit committee chairs who also have an executive role, such as CEO. It is important that audit committee members have sufficient time to devote to the role and should not accept too many mandates.

There is little external visibility in Switzerland over the work and conclusions of the audit committee and recommendations to the board of directors. This is partially due to confidentiality but also lack of detailed disclosure requirements in Switzerland.

2 FEE survey

Heads of audit committee who also have an executive role

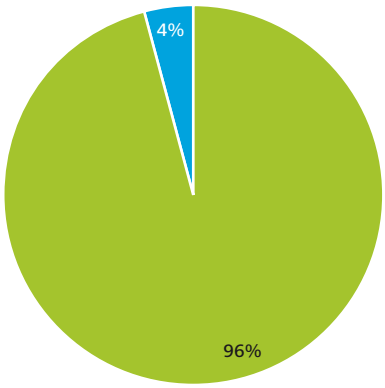


Yes No

The average age of a SMI/SMIM audit committee member is 60 and its chairperson is on average 61 (SMI) and 63 (SMIM) which explains that the vast majority of them have retired from their executive functions. The youngest chair is 48 (Adecco) and the oldest 75 (Richemont).

In 2011, there were 4 female chairpersons (Logitech, Roche, Swatch, Syngenta). These women have also non-executive or executive positions in other companies and their average age is slightly lower (2011: 59).

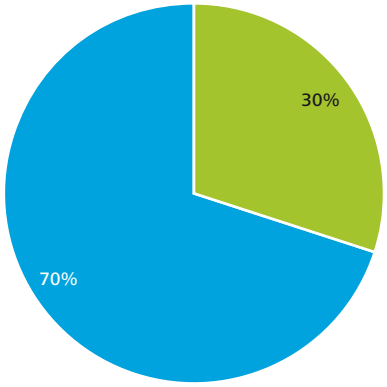
Female chairpersons



Male Female

In terms of nationality, 32% of SMI audit committee members are Swiss compared to 64% of SMIM audit committee members. Similarly, 40% of SMI chairpersons are Swiss compared to 68% of SMIM chairpersons. This reflects the fact that the SMIM consists of more Swiss-based companies rather than international companies headquartered in Switzerland.

Nationality

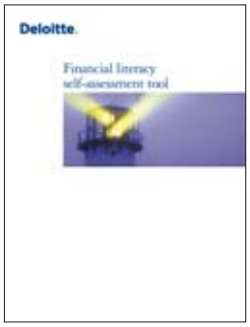


Swiss Non-Swiss

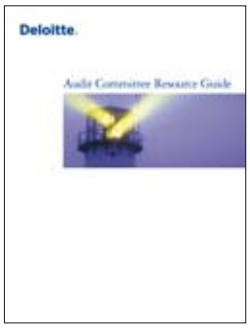
Most chairs have been in the position for between 1 and 12 years, with an average tenure of around 3.5 years.

Members, especially the chairpersons, do not usually have other subcommittee memberships, presumably given that the role of audit committee chairperson demands significant investment and time. There are however, some exceptions. 21% of the chairpersons in 2011 were also members or chairs of the nominations and remuneration committee, the corporate governance committee, or the risk committee. Tasks are, however, for the most part, shared out based on skills and competencies. Interestingly at Swatch, the full board sits at both subcommittee meetings and the chairwoman also chairs the subcommittees. In Switzerland it is permitted to elect the chairman of the board as audit committee chair (the chairperson also chairs at least 2 subcommittees in 58% of SMI/SMIM companies) whereas in many European countries it is not permitted.

The average age of a SMI/SMIM audit committee member is 60 and its chairperson is on average 61 (SMI) and 63 (SMIM) which explains that the vast majority of them have retired from their executive functions.



Deloitte has developed a financial literacy self-assessment tool[3] which covers some of the key questions audit committee members should be asking themselves as a minimum on financial accounting and reporting issues.

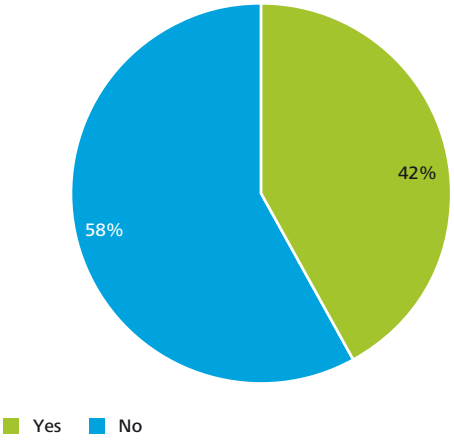


The Deloitte Audit Committee Resource Guide[4] provides audit committee members with useful and comprehensive guidance on their role and responsibilities.

Financial literacy

The economiesuisse Swiss Code of Best Practice on Corporate Governance states that "a majority of members, including the Chairman, should be financially literate". European legislation (8th directive) currently requires at least one member to have competency in accounting and/or auditing whereas the new EC recommendation is that members should collectively have a recent and relevant background in and experience of finance and accounting for listed companies. In the US, NYSE listed companies' audit committees must nominate a financial expert and all audit committee members are required to be financially literate. In 2011, 42% of SMI/SMIM audit committee members have an accounting qualification, which is one indicator of financial literacy, practical hands-on experience being another indicator. The audit committee does usually include at least one certified or chartered accountant, with at least 4 SMI companies having an ex-audit partner as its audit committee chairman. This is helpful given that one of the primary focus areas of the audit committee is the quality of the financial reporting including publicly reported financial statements, interim financial statements, accounting policies etc. but also financing decisions. The SIX Exchange Regulation monitors compliance with accounting standards (IFRS, US GAAP etc.) which are increasingly complex; hence a thorough understanding of accounting issues is a must for the audit committee's repertoire of skills. The audit committee must be able to confidently challenge management in their accounting policy choices and accounting treatment of complex transactions.

Chairperson with a recognised accountancy qualification



In terms of background, prior to being appointed to the current role, several chairmen held senior executive positions with a Big Four accounting and advisory firm.

Looking ahead – future developments

- **Roles and responsibilities** continue to evolve. As we have seen there are more and more responsibilities surrounding compliance with corporate responsibility and sustainability, as well as risk assessment and reinforcement of internal controls. The audit committee is increasingly qualified to deal with the complex issues it faces in terms of financial reporting which is riddled with complexities as a result of market conditions and sophisticated financial rules and structures.

- **Identifying and developing finance talent** – The audit committee's work is heavily dependent on the financial information and performance reporting that it receives from the CFO and the finance team. Therefore it is important that vigilant audit committees need to focus on identifying and developing finance talent, as companies face greater business challenges in response to increased globalisation and financial regulation as well as a shortage of senior finance leaders. While there may be some overlap with the role of the nominations committee's remit, it is important for the audit committee to ensure that the company has the appropriate level of resources and a finance talent strategy.

- **Independence** – Trends towards a truly independent audit committee are visible, with only a few remaining family-founded Swiss companies having audit committee members with a parallel executive position. Although this does appear to be dying out. As audit committee members have more frequently several ongoing non-executive roles, this provides for a diverse experience as well as financial viability to make being an audit committee member a full time profession.

The audit committee is increasingly qualified to deal with the complex issues it faces in terms of financial reporting which is riddled with complexities as a result of market conditions and sophisticated financial rules and structures.

3 www.corpgov.deloitte.com
4 www.corpgov.deloitte.com

Risk oversight

The crisis facing the global economy, and subsequent volatility, has made risk management an active concern for board members. Boards are forced to take much greater interest in how they and their organizations monitor and manage risk. These risks range from operational to strategic and environmental; from safety in a factory to the potential impact of a sovereign default. Directors are now more conscious of external factors or disruptive business models that can swiftly transform a mature industry or business.

Over the last few years, rating agencies have intensified their scrutiny over the way organisations manage risks. Among them, at least on glabal rating agency now considers Enterprise Risk Management (ERM) an official part of the credit rating process for all companies (financial and non-financial institutions). Accordingly, risk governance is now directly linked with credit rating, and ultimately, cost of capital.

Overall responsibility for risk oversight

The ultimate competency for risk management oversight resides with the board of directors. Nevertheless, boards may assign this responsibility to the audit committee or a dedicated risk committee. Frequently, the audit committee is the default committee for risk oversight.

Among SMI companies, we found that audit committees generally take on the risk oversight role (35%). However, many boards (35%) also involve the risk committee to enable an appropriate level of expertise to be applied to address the full range of risks facing the organization. Finally, for the remaining 30%, risk oversight is dealt with by the entire board.

Among SMI companies, all financial institutions have a separate risk committee, while only 7% of non financial institutions do so.

All financial institutions in the SMI have a risk committee overseeing their risk management processes, compared to 7% for the corporates.

Responsibility for risk oversight % (SMI)

Extract of the Swiss Code of Best Practice for Corporate Governance
Board of Directors should provide for systems for internal control and risk managment suitable for the company.

- The internal control system should be geared to the size, the complexity and risk profile of the company.
- The internal control system should, depending on the specific nature of the company also cover risk management. The latter should apply to both financial and operational risks.
- The company should set up an Internal Audit funtion which should report to the Audit Committee or, as the case may be, to the Chairman of the Board.

"Risk committees are still uncommon in corporate groups, however in my experience, one of their positive impacts is to raise awareness of the risks in the organisation."

Andreas von Planta, independent board member Holcim and Novartis

Among SMIM companies, the figures are lower and not all companies disclose this information.

Responsibility for risk oversight for SMIM Companies %

Defining risk oversight

Risk oversight roles and responsibilities should be formally defined and clearly understood by board members.

Successful risk oversight depends, in part, on the ways in which the risk committee fulfils its responsibilities and interacts with the executive team, the Chief Risk Officer (CRO), the board and key stakeholders. The board and risk committee can define such responsibilities in any given area by including them in the risk committee charter.

Based on the annual reports of SMI companies, the most common responsibilities relating to risk oversight are defined as follows:

- Establish the right environment for the embrace of ERM by senior executives (tone-at-the-top).
- Oversee management's approach to ERM, including the determination of the enterprise's appetite for risks.
- Monitor the overall risk management process to assess the effectiveness and adequacy of risk management activities.
- For risk/audit committees, approve selected risk limits and make recommendations to the Board.
- Review and approve the most important risk exposures in all major risk categories, as well as new products or strategic expansions.
- Deliberate on the adequacy of measures in place to mitigate and manage risk, and assign responsibility to designated managers for implementation of such measures.

Responsibility for risk at the management level

Since one of the board's main responsibilities is to oversee the strategy-setting process, helping management incorporate risk management at the operational level is an inherent part of board's role.

We observed that almost 60% of SMI companies have established a Chief Risk Officer (CRO) or a head of the Group Risk Management to lead risk management. In particular, all financial institutions must nominate a CRO. CROs typically report either to the CEO or a management-level risk management committee. In the absence of a CRO, in 20% of companies the responsibility for risk management is supported by the executive committee and in 15% of companies by the CEO. For the remaining companies the responsibility for risk, at the management level, rests with the CFO. For SMIM companies, we note that many companies do not disclose this information.

Responsibility for risk at management level (SMI) %

Responsibility for risk at management level (SMIM) %

"During the implementation of a risk management system within an organization, the related tasks are often perceived by the operational staff and management as additional administrative tasks. A good way to motivate those involved is not to treat only the risks but also to introduce opportunity management."

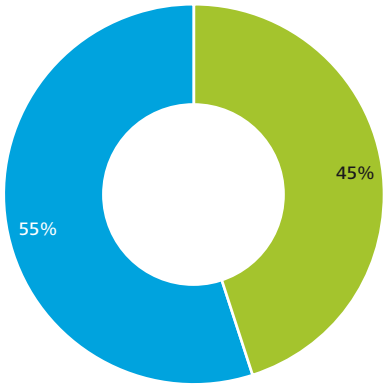
Christian Budry, Independent board member, Romande Energie & Publigroupe, audit committee chairman

Risk management policy

Risk management policies are designed to strengthen risk management practices throughout the organisation by providing clarity on the requirements and boundaries of ERM, including a formally defined risk appetite.

Not all SMI companies disclose their risk policy. Of the companies listed, 45% disclose their risk policy, in whole or in part, in their annual report or on their website.

Disclosure of RM policy



Yes
Not disclosed

Our review of the disclosed risk management policies shows that few of them actually describe the principles, objectives, responsibilities and process for risk management in publicly available documents, while this information is undoubtedly much more detailed in internal documentation.

Among SMI listed companies, only three reference risk appetite as part of their annual disclosure. Again, we found that organizations with formalized risk appetite or tolerance statements are mainly from the banking and insurance industries. For example, Credit Suisse indicated in its annual report that they "continue to review their risk appetite framework which establishes key principles for managing their risks to ensure an appropriate balance of return and assumed risk, stability of earnings and capital levels they seek to maintain." The definition of the risk appetite is defined by their Board. Furthermore, Credit Suisse disclosed its risk appetite framework.

Risk management leading practice

- The principles of risk management should be aligned with the organization's strategy and objectives.
- Risk policies should be well defined and approved by board. They should establish and clearly define the risk philosophy, appetite and ERM requirements of the organization.
- Risk management policies should be documented for all principal risks and should explicitly document roles, responsibilities, accountability, expectations for compliance with policies and the consequences for non-compliance. They should be regularly reviewed and communicated throughout the organization.
- Management-level risk policies and procedures should be established to drive risk management actions.
- An implementation plan should be developed to "operationalise" risk management policies that include communication, training, monitoring and reporting.

Our review of the disclosed risk management policies pointed out that few of them actually describe the principles, objectives, responsibilities and process for risk management in publicly available documents, while this information is undoubtedly much more detailed in internal documentation.

The Code of Obligations – Art. 663b: According to the Code of Obligations – Article 663b, all Swiss companies are required to conduct a risk assessment and disclose information about this process in the notes to the financial statements.

Risk assessment

Risk assessments provide a structured and disciplined approach to evaluate and prioritise risks based on each risk's potential to impact the achievement of business strategies and objectives.

All SMI companies indicate they have a risk assessment process in place – this is a Swiss law requirement since 2008. In terms of disclosure however, little risk information is disclosed publicly or the disclosure is concise; only the most generic and inherent risks are disclosed.

Although all SMI companies indicate they have a risk assessment in place, the approach adopted can vary a lot. While most companies start with a 'top down' risk assessment, those who have mature risk management processes in place complement this approach with 'bottom up' risk assessments. For example, in its annual report, Nestlé describes a two-tiered approach to the evaluation of risk. "The 'Top-Down' assessment occurs annually and focuses on the Group's global risk portfolio. It involves the aggregation of individual 'Top-Down' assessments of Zones, Globally Managed Businesses, and all markets. It is intended to provide a high-level mapping of Group risk and allow Group Management to make sound decisions on the future operations of the Company ... The 'Bottom-Up' process includes assessments performed at an individual component level (business unit, function, department or project). The reason for performing these component level risk assessments is to highlight localised issues where risks can be mitigated quickly and efficiently."

As an example, Novartis disclosed elements of its key risks under the section "Factors affecting results of operations" in another section of its annual report and range from the aging global population and shifting demographics to global economic crisis, increased regulatory/safety hurdles, patent expirations and generic competition pressure or risks of liability resulting from manufacturing issues or legal proceedings. These factors "have created a business environment that has significant risks", according to Novartis.

From a strategic standpoint, "outside the box" thinking about risk remains critical. Asking "What might cause the business or a strategic objective to fail?" may not only better prepare the organization to mitigate future losses, but can also generate new strategic ideas that create value.

Risk assessment: Considerations for board members

- **Who should be involved?** The risk assessment process should consider input from line managers and functional representatives, as well as business-unit and executive leaders. Gathering perspectives from the people "on the ground" goes a long way toward helping leaders understand what risks could have the most significant impact on the organization. Also, involving Board members is good practice in order to reflect governing body concerns into the organizational risk profile. In addition, this helps increase communication with the Board and aids them to achieve their risk oversight responsibilities.

- **Top down or bottom up?** Depending on its size and complexity, an organization can take several approaches to breaking down its risk assessment activities into meaningful, manageable chunks. One frequent approach is to have each business unit, division, or location perform its own risk assessment, with the results to be aggregated later and reported to management for review and validation.

- **Frequency** – A good practice is to conduct a risk assessment exercise on a yearly basis, with quarterly reviews as part of risk committee or management committee agendas. Risk assessments shall also be conducted on an as needed basis, when new risks are identified.

- **Risk assessment is only a starting point** – Too often organizations conduct a risk assessment but do not follow through. Risk assessments should create the foundation for strategic planning and decision making through targeted risk responses. Risk owners should be identified for the most critical risks and report to Executives and the Board as part of quarterly risk reporting.

Board risk reporting

Risk reporting to board of directors is a growing area of focus for many organisations. This type of reporting refers to the continual flow of risk information to and from the various risk governance groups. Although there is little disclosure among SMI/SMIM companies in terms of board reporting, the following examples of information are reported to the Board:

- Enterprise Risk Management (ERM) framework, full risk spectrum (Bank, market, credit, reputational, capital, financial, strategic, operational and legal) and proposed actions to be taken.
- Risk guidelines, risk analytics, compliance and policies.
- Mitigation actions and measures, possible opportunities and steps taken to minimize risks including any related insurance.
- Effectiveness, integrity and appropriateness of the group's risk management.
- Results of risk management process (risk identification, risk prioritization, risk assessment, risk response, risk monitoring, mitigation actions, operational risk, risk measurement methodologies).

Board reporting leading practices

- **Frequency** – ERM reports should be provided to the Board on a quarterly basis. In addition to regular reporting, organizations should also consider ad hoc/ unscheduled reporting, for example, when a major change to the risk profile occurs or when a risk-related decision is urgently required from the Board.
- **'Less is more'** – Voluminous reporting on all identified and assessed risks are typically too long and detailed for the Board. Succinct results of the consolidated risk assessment (e.g. prioritized significant risks faced by the organization) and other pertinent risk related information are preferred.
- **Dashboard reporting** – Presenting a holistic, comprehensive view in an easily understandable format, utilising tables, charts and graphs help to highlight key messages. Dashboards can provide an effective display of data (especially for the overall view of an organization's risk profile) and allow visualization of comparative data analysis (e.g. risk exposure current quarter vs. previous).

Example of a risk dashboard

Risk category	2011 trend	2012 trend
Reputation	Stable	Stable
Systemic	Stable	Stable
Regulatory & Legal	Improving	Negative
Competitor	Stable	Stable
Strategic	Stable	Improving
Operational	Stable	Stable
Credit	Negative	Stable
Market	Stable	Stable
Liquidity and Funding	Stable	Stable

No significant risks
Heightened awareness
Significant risks exist

Looking ahead – future developments

Looking ahead, risk oversight practices in Switzerland can only get stronger and mirror those found in the financial services companies that often have a more developed risk infrastructure in place. More specifically, we may expect:

- more defined responsibilities and accountability: with or without a risk committee, the board should clearly define its role in risk oversight and establish clear risk-related roles amongst its committees and members;
- greater board education: today's boards are still struggling with how to define and fulfil their governance roles in light of changing risks and regulations;
- closer interaction and interfacing with executive management to address the real value-killer risks within the organization.

On the regulatory side, we can expect more stringent rules, as we have seen in the US with the SEC now requiring increased proxy disclosure regarding the board's role in risk oversight or with the Dodd-Frank Wall Street Reform. This reform promotes enhanced prudential supervision through the establishment of a board risk committee with a formal written charter as well as more independent and risk qualified board members, based on the company's nature of operations, size of assets and other appropriate criteria.

Looking ahead, risk oversight practices in Switzerland can only get stronger and mirror those found in the financial services companies that often have a more developed risk infrastructure in place.

Fraud risk oversight

Despite stronger focus by companies to prevent fraud, the estimated losses related to fraud still represent a significant proportion of companies' revenues. Personal liabilities resulting from a lack of oversight are said to represent trillions of USD (according to the World Bank). Pressure on the board to protect the most valuable assets of the company as well as its reputation is becoming one of the priorities to be able to achieve sustainable growth.

The primary responsibility for the prevention and detection of fraud rests with the board of directors. Active oversight of fraud, both prevention and detection, and in particular the oversight of risk of management override of controls which could potentially lead to fraudulent financial reporting or misappropriation of assets. A new trend has also emerged, the biggest threat is now coming from a company's own employees at management and executive levels, perhaps as a result of a lack of employee loyalty and the economic downturn.

Hot Topics on the Board agenda

1. Tone at the Top
"Tone at the Top" refers to how an organisation's leadership creates an ethical atmosphere and culture within the entity.

6. Fraud Management
Fraud Management is probably the most complex area. The Board needs to feel comfortable that risks are managed. Efficiency of the monitoring is a key factor of success.

2. Commitments
The starting point for mitigating appropriately the risks of fraud is to have the support from the Board. In the current downturn environment there is a heightened risk of fraud.

5. Fraud Risk Assessment
Fraud risk assessment is an important exercise which should include the Board inputs and validation.

3. Roles and Responsibilities
In SMI/SMIM companies, the responsibilities for fraud risk are shared between legal, compliance, HR, internal audit, risk functions and security as well as decentralized at the country level.

4. Competencies
A board has to be knowledgeable on key fraud issues specific to the industry, the market, transactions/ partnerships as well as its own organization.

The Swiss Code of Best Practice on Corporate Governance deals with the risk of conflicts of interest and advance information. For example: "Each member of the Board of Directors and Executive Board should arrange his personal and business affairs so as to avoid, as far as possible, conflicts of interest with the company."

"The Board of Directors should regulate the principles governing ad hoc publicity in more detail and take measures to prevent insider-dealing offences."

Swiss legal duties of the Board of Directors

The laws and regulations that Swiss directors have to deal with are complex. As well as resulting from their usual duties as directors (articles 716a, 725 CO), board members may also be held personally liable in case of negligence or intentional violation of their duties (article 754 CO) and in extreme cases may be held criminally liable if they personally commit a criminal offence. According to article 102 para 1 of the Swiss Criminal Code, if a felony or misdemeanour is committed in a company when carrying out commercial activities in accordance with its goals and it is not possible to attribute the act to any specific individual, then the felony or misdemeanour shall be attributed to the company.

Board performance evaluation

In order to ensure that the roles and responsibilities of the Board of Directors are effectively performed, companies should conduct a regular board performance evaluation. As of today, the board performance evaluations are not mandatory in Switzerland although it is a leading practice.

In 2011, 80% of SMI companies declare that a board evaluation is performed. This is a marked improvement on the previous year (2010: 60%) and perhaps due to Swiss companies aligning their corporate governance disclosures with best practice. Generally this declaration is in the form of one sentence describing the process, making it difficult to draw meaningful analysis on the effectiveness of board evaluations in SMI companies (see example of Actelion annual report extract). However only 5 of the sampled SMIM companies disclosed that an annual board evaluation is performed. As a comparison, the UK Corporate Governance code requires a statement of how performance evaluation was conducted for the board, its committees and individual directors. In 2011 96% of companies in the FTSE 350 (2010: 92%) made such a disclosure.

Extract from Actelion Annual report 2011

> Furthermore, the members of the Board of Directors are required to regularly fill in a self-assessment form covering the performance of the full Board, the Committees and their individual performances.

Why conduct a board evaluation?

A performance evaluation may highlight the need to examine issues such as the Board's composition and qualifications, members' understanding of complex accounting and financial reporting issues and meeting agendas.

Among other benefits, board evaluations can:

- Allow directors to enhance skill sets;
- Ensure the board is focused on strategy;
- Enhance the effectiveness of boards, committees and individual directors;
- Ensure the right balance of skills and competencies within the board;
- Improve communication among both directors and management; and
- Satisfy stakeholders increasing expectations.

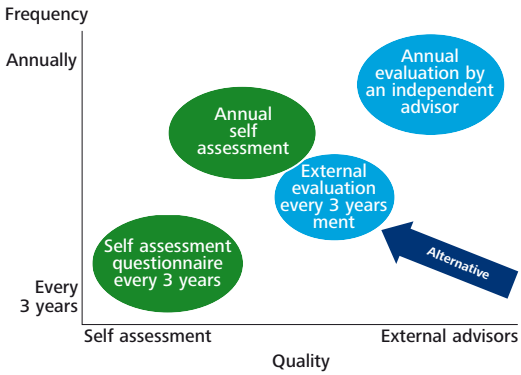
Extract for the Swiss code of best practice for corporate governance
The Board of Directors should discuss annually its own and its members' performance.

What type of Board Evaluation?

To develop a performance assessment the Board must first consider what it would like to achieve from the assessment. Consideration should be given to both how the assessment is performed and acted upon once completed. There are various evaluation approaches and each board should apply a process that best meets its needs.

Several elements should be considered in shaping the assessment process. First, various parties may lead the assessment, e.g. the chairman, secretary general, the audit committee; the entire board or its nominating/governance committee; or the internal auditors. Some Boards have found it useful to engage an independent third party to assist with the evaluation process. A combination of these may prove optimal. For example, a Board may choose to engage an adviser every two or three years, and facilitate the process internally in the other years. The format of the evaluation is another consideration: in the case of a self-assessment, Board members may complete a questionnaire collectively or individually.

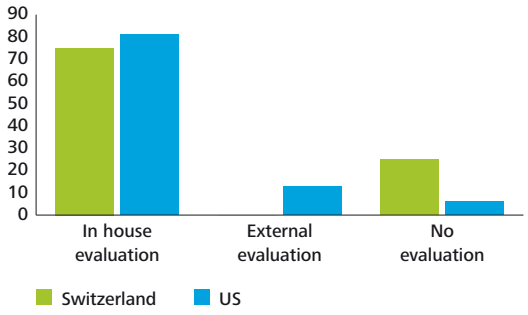
Market trends



> "An assessment every 2-3 years is the right frequency."

Dr DeAnne Julius, Independent board member and Roche audit committee chair

Board performance evaluation comparison (%)



The mostly frequently practiced type is the board self-assessment. It involves the board assessing its own effectiveness, typically against its mandate and via a self-administered, written questionnaire. 80% of the SMI companies in our sample indicate they perform an annual board evaluation, compared to 94% in the US according to a recent Deloitte survey[1]. These evaluations are typically internal assessments, with no companies in our sample disclosing the involvement of an independent advisor to run the process.

The table below highlights advantages of using either an internal or external evaluation process:

Internal evaluation	External evaluation
Lower cost	Benchmarking
Higher confidentiality	Experience
Ease of organisation	Independence and Objectivity
Knowledge of board processes	Comprehensive documentation

If the assessment is conducted internally, the format may consist of evaluation forms, interviews, or both. The party leading the evaluation may consider soliciting information from individuals who have significant interaction with the Board. The Board may want to consider changing the process periodically to keep it fresh. Documentation is another significant concern, and the advice of corporate counsel is often important in this matter.

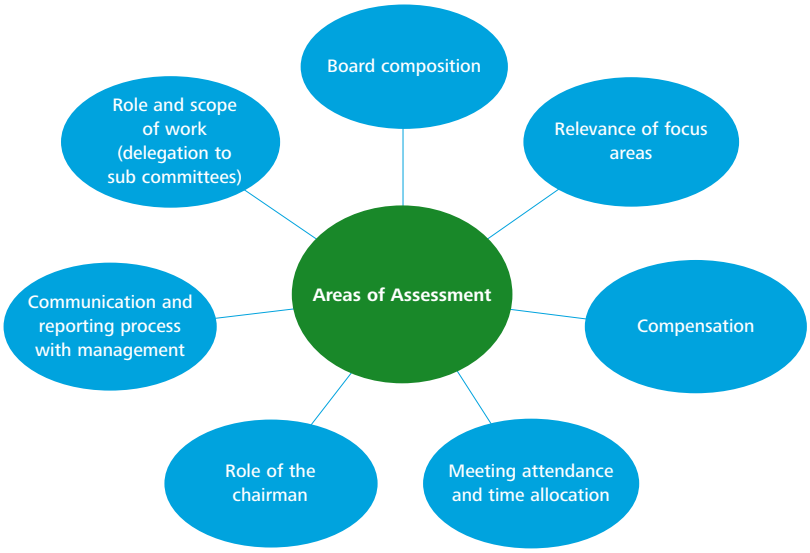
As a comparison, in the UK, the Corporate Governance Code requires that the performance evaluation process of FTSE 350 companies be externally facilitated at least once every three years. According to a recent Deloitte survey[2], in 2011 38% (2010: 26%) of the FTSE 350 used an external facilitator for board performance evaluations.

Deloitte's point of view

An evaluation process that is conducted in a thoughtful manner can yield insights that are extremely valuable to the board and, by extension, the company. On the other hand a check-the-box evaluation has little potential to be helpful. Areas for boards to consider include:

- **Where the board spends its time**. As the board's role evolves and changes occur in the organization's operating environment, boards should periodically review the range of their responsibilities to ensure they allocate sufficient attention to all areas of their mandate.
- **Where the board allocates its responsibilities**. Boards should periodically review the mandates of their committees to ensure they are appropriate and that committee workloads do not become too onerous.
- **What information the board requires**. As the board's responsibilities evolve, so does the information it requires.

Board performance evaluation



Extract from BP Annual report 2011

Board evaluation

We undertake an annual review of the board, its committees and individual directors

The chairman's own performance is evaluated by the chairman's committee (led by the senior independent director).

In 2009 and 2010, we undertook an external review of the board's performance. In 2011, we decided to continue external facilitation as a way of building on the past year's results and providing a robust, third party insight into the board's effectiveness. To enable continuity and comparability of results over the two year period, we used the same external facilitator as for the 2010 review.

1 December 2011 "Board Practices Report"
2 2011 Deloitte Gems and jetsam "Surveying annual reports"

Tips for a successful board evaluation

- Perform the evaluation in a thorough manner rather than as a compliance exercise.
- Consider using the results as a catalyst to re-engineer processes, procedures, and agendas, which should influence where the Board is spending its time
- Select a coordinator and establish a timeline for the process.
- Process can include a peer review where fellow Board members assess each other against set criteria.
- Developing and executing a plan for improvement is the ultimate objective of the assessment.
- In addition to board members completing the self-evaluation, ask individuals who interact with the board members to provide feedback.

Looking ahead – future developments

Board evaluation practices have increased in Switzerland over the past several years although the level of disclosure and transparency is extremely low. They will continue to be a focus for stakeholders in the capital markets. In our view, there is an expectation that the board performance evaluation process will become more in-depth and robust, and more companies will engage third party independent specialists in the future.

"The annual evaluation of the performance of the Board of directors is best practice nowadays, although there is still as certain amount of uncertainty as to the exact process to implement. My experience is that more value is added when a neutral third party conducts the annual evaluation."

Christian Budry, Independent board member, Romande Energie & Publigroupe

Remuneration

Companies aim to set competitive levels of compensation in order to attract, motivate and retain the best leaders. Remuneration principles are often defined to maintain a company's competitive edge over its competitors, the objective being to retain executives and non executives who will drive the business to outperform competitors.

Remuneration reports

In this section, we analyse the remuneration report and related disclosures presented in the 2011 annual reports of SMI and SMIM companies.

The remuneration report is the best and most prominent opportunity a company has to communicate the links between pay and business strategy and to demonstrate the rationale and philosophy behind the numbers.

The requirement to disclose this information has led to improved company transparency on pay; but over time remuneration reports have become increasingly lengthy and complex. This has made it difficult to identify the main facts and figures, which are often buried in a raft of other information. And despite the length of remuneration reports they are often lacking in information which shareholders may find helpful when scrutinising remuneration proposals. For example, clear explanations about the link between pay and performance, and between executive pay and pay across the organisation as a whole.

43% of companies analysed presented their compensation policy in a separate report, while the remainder included this information within the Corporate Governance report. The length of the remuneration reports ranged from 4 to 46 pages for the SMI and from 1 to 36 pages for the SMIM.

There are significant differences between companies in the financial sector and the non-financial sectors in terms of average number of pages. The average length of the report is 27 pages for the financial sector compared to 12 pages for companies in other sectors. These differences may be explained by the FINMA circular 10/1 which entered into force on January 1, 2010 and which requires additional disclosures.

Our research revealed that remuneration reports are not always clearly structured or easy to understand. Explanations for valuation methodology or accounting basis may be presented in other sections making it hard for the reader to have a clear understanding. The links between pay and business strategy are not always explained or understood and the reports do not systematically disclose the level of detail identified in relevant shareholder guidelines.

Remuneration committee

All SMI companies have a compensation committee, consisting of between 2 and 6 members who meet on average between 1 to 8 times a year. The compensation committee sets compensation levels that are aligned with the organization's best interests, its mission and strategy. The aim of this committee is to make recommendations to the board of directors which will finally approve the remuneration.

As suggested by the Swiss Code of Best Practice for Corporate Governance, a majority of the members of this committee should consist of non-executive and independent directors. The chairperson of the board is a member of the compensation committee in 26% of SMI/SMIM companies. Best practice recommends that the chairperson does not participate in the discussions on his or her own remuneration. In some companies, the chairperson leaves the meeting when the committee is discussing his or her remuneration. In other cases, the chairperson is present but has no voting rights.

... over time remuneration reports have become increasingly lengthy and complex.

Components and structure of remuneration

Components of compensation to board of directors

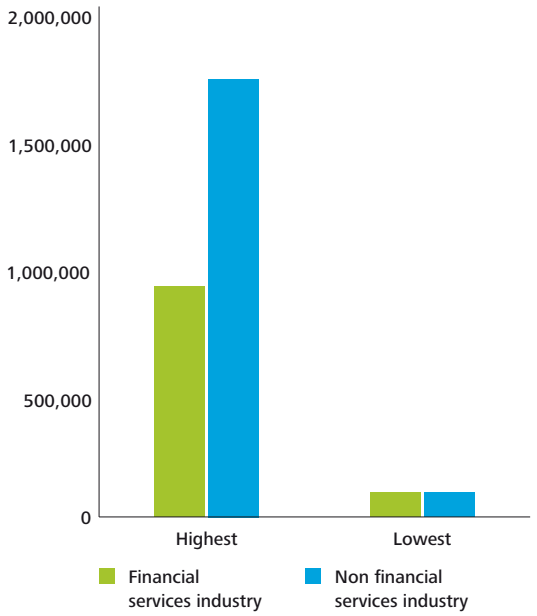
Global overview

In 2011, the total remuneration paid to board members per company in the SMI ranged from CHF 2.3 million to CHF 18.8 million, with an average of CHF 6.5 million versus CHF 7.0 million in 2010. This slight decrease is driven by lower compensation of financial companies of the SMI. For SMIM, the total remuneration paid per company ranged from CHF 0.5 million to CHF 5.0 million with an average of CHF 2.2 million. The wider range of remuneration levels for the SMIM may result from the broader range of company size, the company results and the sectors in which companies operate. According to a European analysis performed by Heidrick and Struggles in 2011, Switzerland is the country with the highest remuneration per board member. However, the United States is quoted to be the highest in the world in absolute terms.

In the tables presented overleaf, we have considered the compensation levels in relation to the market capitalisation of SMI and SMIM companies.

We observe a relatively strong correlation between the size of the company in terms of market capitalisation and the level of remuneration. There is one exception, this being the tranche of CHF 10 – 19 billion which shows the lowest chairman compensation. This is driven by Swisscom, where levels of compensation may still be influenced by the fact that the majority of shares are held by the Swiss government. We also observe a gap between the level of remuneration paid to the chairperson compared to the other board members. For instance, the average remuneration paid to the chairperson of SMI companies amounts to CHF 3 million, compared to CHF 0.3 million paid to the other members. This gap is mainly due to the increased duties, responsibilities and personal investment of the chairperson, as well as a higher level of visibility and accountability for the strategy and results of the company, which evidently increases the size of this remuneration package, but also we observed a higher proportion of variable remuneration.

Average remuneration per board member including Chairman (CHF)



> "Public company remuneration levels are highly mediatised. What matters to analysts is more the structure of remuneration i.e. does it provide the right incentives to management" rather than the actual amounts they receive."

Olivier P. Müller, CFA, Director, Manager Financial Analysis, Equity Research, Credit Suisse AG

Point of view – economiesuisse

"economiesuisse condemns excessive remuneration and recognises the need for action. But the initiative launched by Thomas Minder is not the right solution since it is harmful for Switzerland. However, economiesuisse is in favour of the indirect counterproposal. If the initiative is rejected, this counterproposal will enter into effect without delay and without the need for additional implementation procedures. It adopts 80 percent of the demands formulated in the initiative, i.e. it strengthens shareholders' rights and enables them to prevent excessive salaries and bonuses. But it also grants shareholders the freedom to organise their company in accordance with the specific needs, and is therefore more liberal and less damaging for Switzerland than the initiative. In terms of regulation, the initiative extends well beyond the issue of remuneration and imposes obligations on companies that have nothing to do with salaries, but are harmful to Switzerland as a business location. Examples include a voting obligation for pension funds, the threat of imprisonment, securing the option of remote voting and limiting the number of external mandates for members of the board of directors and management. The indirect counterproposal does not make such demands."

Market capitalisation SMI at YE 2011	Chairman Min	Chairman Max	Chairman Average
CHF 4 billion – 9 billion	787'482	2'601'609	1'590'869
CHF 10 billion – 19 billion	307'000	4'804'000	1'700'761
CHF 20 billion – 99 billion	937'262	4'334'881	2'003'816
CHF 100 billion – CHF 178 billion	6'973'821	12'820'246	9'682'845

Market capitalisation SMI at YE 2011	Other Members of the Boards Min	Other Members of the Boards Max	Average
CHF 4 billion – 9 billion	172'255	331'515	234'949
CHF 10 billion – 19 billion	96'622	576'750	268'552
CHF 20 billion – 99 billion	219'118	700'000	377'705
CHF 100 billion – CHF 178 billion	367'326	605'414	449'301

Market capitalisation SMIM at YE 2011	Chairman Min	Chairman Max	Chairman Average
CHF 0.5 billion – 5 billion	160'000	3'550'000	865'038
CHF 5 billion – 13 billion	400'000	2'734'000	1'163'902

Market capitalisation SMIM at YE 2011	Other Members of the Boards Min	Other Members of the Boards Max	Average
CHF 0.5 billion – 5 billion	75'636	365'376	165'403
CHF 5 billion – 13 billion	145'000	479'032	278'925

Total remuneration includes fixed, variable and other benefits (e.g. pension and allowances)

Point of view – Ethos Fondation

Popular initiative "against excessive pay": Ethos supports the counter proposal
On the 3rd of March 2013, Swiss citizens will vote on the popular initiative "against excessive pay" launched by the entrepreneur Thomas Minder. If the popular initiative is rejected, a revision of the Code of Obligations shall be automatically approved, which is in fact the parliamentary counter proposal. Compared to current law, both the popular initiative as well as the parliamentary counter proposal constitute significant progress in terms of rights for shareholders. Overall, however, it is our view that the counter proposal strengthens shareholders' rights more appropriately than the popular initiative.

1. The counter proposal gives shareholders more rights than the initiative on decisive points
Only the counter proposal foresees a set of rules on remuneration and gives the General Assembly the right to vote. This permits shareholders to not only decide on the amount of remuneration, but also on the whole structure, in particular bonuses and participation plans, which are often the cause of high salaries.

Indeed, it is only the counter proposal which requires the publication of the minutes of the general shareholders' meetings. This is a fundamental element of shareholder democracy because it allows shareholders to know the results of the voting and the signals they send to management.

Finally, only the counter proposal foresees that the independent representative should abstain in the absence of voting instructions. Moreover, this person does not have the right to a general proxy of a shareholder. This prevents an automatic approval of the resolutions of the Board of Directors.

2. The counter proposal guarantees shareholders an efficient control and a balanced governance of listed companies
The counter proposal provides a balanced distribution of competencies between shareholders and the board of directors. The general meeting of shareholders sets in a binding manner the board remuneration. On the other hand, the general meeting decides whether the remuneration of the senior management is subject to an advisory or binding vote. In addition, the general meeting sets the remuneration rules via a binding vote. Furthermore, with 0.25% of the share capital, a shareholder may submit a resolution to the General Assembly to amend this set of rules.

3. The counter proposal will be effective immediately as part of the law
The counter proposal's provisions would enter into force immediately as part of the law. However, the Initiative sets new rules that would need to be included in the Federal Constitution, for which the implementing rules would need to be defined only following a long legislative development process.

The highest average remuneration per board member amounted to CHF 0.7 million (SMIM – CHF 0.5 million) while the lowest average remuneration amounted to CHF 0.1 million (SMIM – CHF 0.1 million). Depending on the activity, the revenues and the geographical coverage, remuneration can vary significantly from one company to another.

Furthermore, the highest remuneration was paid by a non financial institution in 2011, while the highest remuneration in 2010 was paid by a financial institution.

Remuneration structure

The structure of the remuneration package of the board of directors is set up to reflect and maintain their independence and oversight role, but also to motivate the board to perform a critical role in the strategic management of the company to enhance the long term value of the shares. It reflects their individual expertise and business experience. 67% of their remuneration consists of a fixed base salary. This salary depends on each member's function within the board as well as his or her involvement in other committees, such as the audit committee. 74% of SMI companies include a variable element in the overall remuneration package. This variable part represents 28% of the total remuneration paid to the entire board including the chairperson.

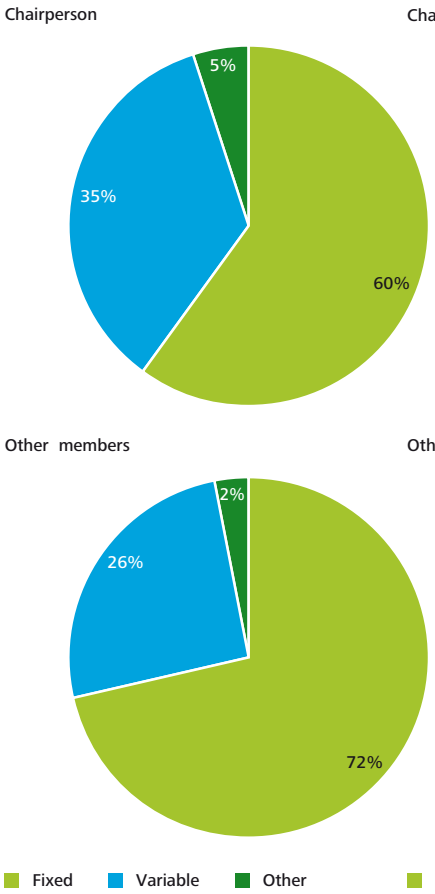
The structure of the remuneration is slightly different for the Chairperson of SMI and SMIM companies. For SMI companies, the fixed element represents 60% of the total remuneration while the variable remuneration represents 35%, reflecting the higher performance-related reward structure. This compares to 68% and 23% respectively for SMIM companies.

Some companies are paying independent board members in shares as best practice guidelines suggest there may be merit in doing so. One of the stated advantages is that it aligns their interest with shareholders. Payment in shares may also aid the recruitment and retention of individuals, particularly for companies wishing to appoint US nationals, as in the majority of US companies the remuneration of independent directors would include awards of shares, share options or restricted shares.

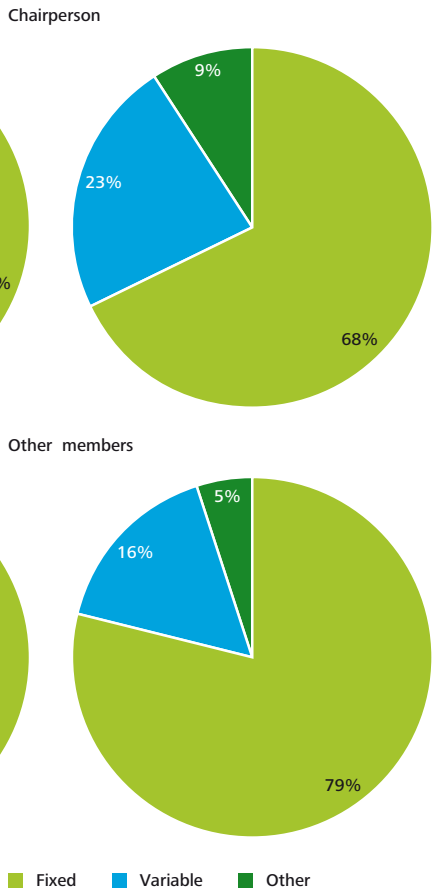
Components of compensation to executive management

In aggregate for the SMI, remuneration to the executive management amounted to CHF 660.2 million which represents an average value of CHF 3.3 million per executive. We observed a drop in total executive management remuneration compared to previous year (-12.3%). This is driven by lower remuneration of management in financial companies and overall, in non financial companies, remuneration remained steady (+3.2%). There is a gap between the CEO's remuneration package and the other executives. In 2011, the average compensation paid to the CEO was double the average remuneration of the other members or the executive management.

Structure of the board's remuneration SMI



Structure of the board's remuneration SMIM



"Increased transparency over remuneration has inevitably led to an increase in compensation over the last few years. In my view, there is an urgent need to simplify remuneration systems in order to improve transparency and understandability."

Andreas von Planta, independent board member Holcim and Novartis

Market capitalisation at YE 2011 SMI	CEO Min	CEO Max	CEO Average
CHF 4 billion – 9 billion	3’374’776	5’669’264	4’743’101
CHF 10 billion – 19 billion	1’464’000	7’687’903	5’151’488
CHF 20 billion – 99 billion	5’820’000	9’913’724	8’342’934
CHF 100 billion – CHF 178 billion	9’799’615	15’719’386	12’390’731

Market capitalisation at YE 2011 SMI	Other members of executive management Min	Other members of executive management Max	Other members of executive management Average
CHF 4 billion – 9 billion	1’357’160	1’876’246	1’587’687
CHF 10 billion – 19 billion	780’667	3’491’250	1’980’615
CHF 20 billion – 99 billion	2’793’413	5’756’874	4’147’715
CHF 100 billion – CHF 178 billion	2’593’364	4’740’808	3’953’509

Market capitalisation at YE 2011 SMIM	CEO Min	CEO Max	CEO Average
CHF 0.5 billion – 5 billion	860’000	8’568’000	2’799’635
CHF 5 billion – 13 billion	3’115’725	8’045’000	4’549’931

Market capitalisation at YE 2011 SMIM	Other members of the management Min	Other members of the management Max	Other members of the management Average
CHF 0.5 billion – 5 billion	637’017	4’527’667	1’377’222
CHF 5 billion – 13 billion	801’857	3’718’250	1’812’785

Investor views on annual bonus plans

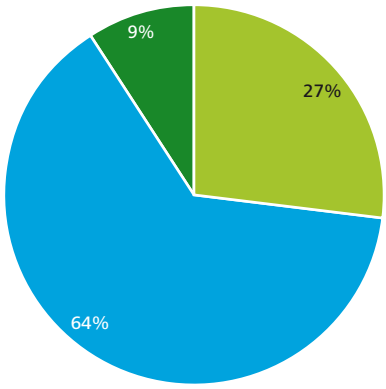
- Annual bonuses are not an automatic entitlement and should reward contribution above the level expected.
- If performance targets are reduced a lower potential would be appropriate. Any increase in bonus potential should be accompanied by an increase in the targets.
- If profit falls, bonuses should fall.
- Bonuses should not encourage the taking of excessive risk.
- Annual bonuses should not be paid if the business has suffered an exceptional negative event.
- A significant proportion of bonus should be deferred and there should be facility to reduce the level of payout if performance is not sustained. However, the use of deferral and clawback provisions do not merit an increase in the size of award.
- There should be better disclosure around performance targets and the extent to which these are met. This might include bonus potential, the balance between financial and individual targets, the measures used and the extent to which the target for each measure was achieved.
- Measures should be clearly linked to business targets.

Extract: Deloitte’s Your Guide – Executive director’s remuneration

We observed a drop in total executive management remuneration compared to previous year (-12.3%). This is driven by lower remuneration of management in financial companies and overall, in non-financial companies, remuneration remained steady (+3.2%).

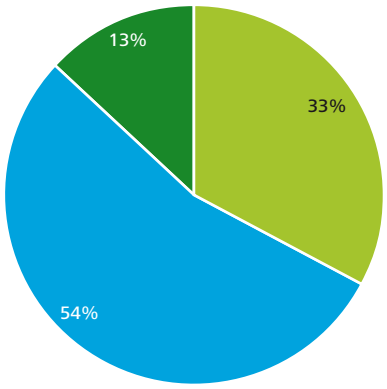
Structure of the executive management's remuneration

Executive Committee SMI



Fixed Variable Other

Executive Committee SMIM



Fixed Variable Other

In our analysis, we note that the structure of the remuneration paid to the executives is complex. On average, the fixed base salary represents 27% of overall remuneration for SMI companies (33% – SMIM). Other benefits received (including employee benefits which vary according to local market practice, social security contributions and pension benefits) represent 9% of the overall remuneration (13% – SMIM). The variable element represents 64% (54% – SMIM).

While the fixed cash base salary is generally determined by the scope and complexity of the role, and the individual's experience, the variable elements of the remuneration are designed to reward performance and achievements. It is important that a firm sets an appropriate ratio between fixed and variable remuneration to ensure that the components are appropriately balanced and that the fixed element is sufficient to allow for the possibility of paying no variable element.

Swiss law requires companies to disclose the total amount paid to the executive committee as a whole as well as the highest amount paid to an executive, specifying the name and function of the member concerned. 6 SMI companies went beyond the requirements of the Swiss Code of Obligations by disclosing the compensation for each member of the executive management individually.

Comparing the remuneration of the companies in the financial sector with the other companies, we saw that the highest salary has been paid by a non-financial institution (CHF 15 million – Novartis) while the highest salary for financial sector companies was considerably lower (CHF 8 million). In the meantime, the variable element remained higher in the non-financial sector than in the financial sector (55% vs. 44%). It is interesting to note that in prior year we observed the opposite trend: the highest salary was paid by a financial institution (CHF 10 million) while the highest salary for a non-financial sector companies was considerably lower (CHF 6.6 million). This change in trend is undoubtedly as a result of the effects of the economic downturn on financial institutions, and in particular stricter cost control measures. The FINMA also issued a circular (2010/1) on the subject of remuneration which entered into force from 1 January 2010. The circular, which applies to banks, securities traders, financial groups and insurance companies subject to Swiss financial market supervision, came as a response to past abusive and inconsistent remuneration. In fact, variable remuneration as an incentive must not serve anymore to incite the carrying of inappropriate risks.

The Circular sets rules on remuneration and is based on ten principles. The main principles state that the remuneration scheme must be simple, transparent, enforceable, and oriented towards long term. Furthermore, the structure and level of total remuneration must be aligned to the company's risk policies and designed so as to enhance risk awareness. Variable remuneration should be granted according to sustainable criteria and control functions must be remunerated in a way so as to avoid conflicts of interests.

SMI

	Financial Instituiutions			Non-financial Institutions		
	Total Executive Committee	CEO	Executive Committee excluding CEO	Total Executive Committee	CEO	Executive Committee excluding CEO
Fixed	27%	32%	26%	30%	28%	32%
Variable	67%	65%	68%	60%	64%	58%
Other	6%	3%	6%	10%	8%	11%

SMIM

	Financial Instituiutions			Non-financial Institutions		
	Total Executive Committee	CEO	Executive Committee excluding CEO	Total Executive Committee	CEO	Executive Committee excluding CEO
Fixed	48%	56%	42%	40%	38%	41%
Variable	40%	33%	46%	46%	46%	46%
Other	12%	11%	12%	14%	16%	13%

Differences and similarities

Fixed versus variable remuneration

The key difference between the board of directors remuneration and the executive management remuneration is the structure of the remuneration. On average, the fixed element represents 62% (2010 – 71%) of the board of directors package compared to 29% (2010 – 23%) of the executive management's remuneration for SMI companies. For SMIM, the fixed element represents 73% of the board of director's package compared to 43% of the executive management's remuneration.

In terms of the composition of the fixed and the variable part of the overall remuneration of the board of directors of SMI companies, the fixed remuneration consists mainly of a cash base salary (82%) (SMIM – 95%) and company shares (18%) (SMIM – 5%), while for the executive management, it consists only of a cash base salary.

The structure of the variable remuneration is becoming increasingly complex due to the introduction of sophisticated long-term incentive programs (LTIP) and deferred bonus payments (DBP). The recent focus on excessive payments and payouts to top executives and non executives and subsequent political and shareholder pressure, has driven changes in executive remuneration around the world. Among the primary trends noted by directors was a shift from short-to-medium and long term remuneration structures; an increase in fixed and cash remuneration over variable and equity-based payments such as options; a push to more closely tie remuneration to performance; and greater disclosure of remuneration levels. Directors are also spending more time creating and reviewing remuneration structures, and used more remuneration consultants as structure become increasingly complex.

SMI

	Board of directors				Executive management			
	Fixed Remuneration	Variable Remuneration Annual Bonus	Variable Remuneration LTI/DBP	Other	Fixed Remuneration	Variable Remuneration Annual Bonus	Variable Remuneration LTI/DBP	Other
	67%	4%	24%	5%	27%	19%	45%	9%
Cash	82%	72%	0%	100%	100%	89%	5%	100%
Shares	18%	22%	93%	0%	0%	11%	80%	0%
Options	0%	6%	7%	0%	0%	0%	15%	0%

SMIM

	Board of directors				Executive management			
	Fixed Remuneration	Variable Remuneration Annual Bonus	Variable Remuneration LTI/DBP	Other	Fixed Remuneration	Variable Remuneration Annual Bonus	Variable Remuneration LTI/DBP	Other
	62%	5%	26%	7%	34%	24%	29%	13%
Cash	95%	100%	0%	100%	100%	100%	1%	100%
Shares	5%	0%	73%	0%	0%	0%	45%	0%
Options	0%	0%	27%	0%	0%	0%	54%	0%

Variable remuneration and LTIPs have a number of objectives, including:

- to align the objectives of the top management with the objectives of the shareholders;
- to encourage the creation of value;
- to reward commitment to the company; and
- to support the achievement of the company's long-term financial and operational goal.

The higher the variable element, the higher is the focus for the board and/or the executive management on achieving success and financial results. The actual remuneration paid will then depend on their performance and ability to achieve the company's objectives. These elements encourage senior management to focus on the performance drivers of long-term objectives.

Remuneration of the chairperson

The remuneration of the board chairperson is becoming comparable to the executive management remuneration in terms of amount and structure, due to the greater responsibility associated with this function, the increased time and personal commitment into the firm's strategic development and implementation. Nowadays, the Chairperson is the representative of the company and the reference point for all the stakeholders.

Investor views on long-term incentive plans

- The level of award should not always be the maximum available and use of exceptional limits must be carefully justified.
- Where the share price has fallen significantly renumeration committees should take this into account when determining the number of shares to be awarded. To do otherwise may have a significant impact on dilution and could result in windfall gains.
- Performance targets should not be changed retrospectively.
- If targets are to be lowered this should be accompanied by a reduction in the potential award.
- Companies should avoid shifting the balance of the package from long term to short term.
- Companies should consider longer performance periods, or perhaps retention of a proportion of the vested award for a period after vesting. Some form of clawback arrangements may be appropriate for long term awards.
- Performance measures should reflect long term strategy. Targets should be set to achieve long term growth and where high growth targets are set these should be justified and information provided on risk management.
- Uncapped incentive plans (such as value creation type plans) are unlikely to be supported.

Extract: Deloitte's Your Guide – Executive director's remuneration

Deferred annual bonus plan and long term-incentive programs

Deferred annual bonus plans align the interest of executive and shareholders through the delivery of awards in shares and provides a retention tool for key executives (as awards are forfeitable on cessation of employment). On the other hand, LTIPs incentivise long term value creation and alignment with shareholder interests. These plans drive and reward delivery of sustained long term EPS and TSR performance.

The distinction between LTIPs and deferred bonus plans has become somewhat blurred in recent years. For this reason we aggregated them in our analysis and deal with both here as each involves free shares and is often of equal interest to investors when assessing the overall effectiveness of remuneration package.

When looking at the composition of the LTIP for SMI executive management, 80% are paid out in shares, 15% in options and 5% in cash, while in prior year 64% of LTI were paid out in shares showing quite a strong shift from options towards shares. Several companies mention their objective to abandon the plans based on options in favour of plans based on shares. The move from options to shares reflects a trend that has been underway for a number of years in the US and in Europe. The rationale for this change in trend is explained by the fact that shares are less volatile and such plans have potentially less dilutive impact compared to options.

While looking at the composition of LTI in SMIM companies, 45% are paid out in shares, 54% in options and 1% in cash.

While the most common criteria for deferred bonus plan payout is retention, long-term incentive plan rely on performance conditions. The following types of performance criteria are typically used:

- Total shareholders return (TSR)
- Economic value added (EVA)
- Earning per share (EPS)
- Average return on equity (ROE)
- Profitability of the group
- Share price
- Organic sales growth
- Asset turnover
- Operating performance

In our study, we noted that the level of detail of disclosures over performance criteria may vary significantly from one company to the other. Some companies do not disclose any information about performance criteria for competitive reasons.

Long term incentives programs: Market trends in Switzerland

- Companies in most industries are moving away from share options to free shares and cash plans.
- Performance measures used for these plans are shifting from standardised (e.g. TSR and EPS) to more customised measures directly aligned with companies' specific strategies and are more reflective of the underlying economics of the businesses or industries (e.g. ROE, EP).
- Longer performance/holding periods have been considered.

Pros and cons of the various types of performance measures

	Capital focused measures	Strategic measures	Share price based measures	Revenue based measures	Profit based measures	Cash flow based measures
Pros	Provides a strong link to shareholder value creation. Gaining greater recognition among analysts.	By linking to business plan and strategy, strategic milestone measures can be (internally) transparent indicators of individual performance e.g. logistic measures and product availability.	Strongest link to shareholder value creation and highly transparent.	For some sectors and recognised measure of performance (e.g. like for like sales or sales per square foot).	More directly under management control. Relatively well understood by investors and common as a short term incentive measure and in longer term plans through EPS.	Provides good indication of ability to cover cost of financing and overall health of business. Many investors are now more focused on cash generation
Cons	May encourage under investment if there is no adjustment for quantum of profit and/or new capital.	May be seen to lack (external) transparency. If decisions on whether the targets have been met are considered arbitrary by participants this may devalue the incentive.	Unlikely to reflect actual annual performance of management. Share price performance already inherent for share awards. Share price reflects market perception of expected performance so may not be a good indicator of performance to date for annual incentives.	May raise questions about measurement and potentially too remote from ultimate delivery of value. Risk of motivating unprofitable growth.	Relative to capital focused measures can be perceived as narrow. Differences between accounting treatment can make inter-company comparisons difficult. Adjustments can make investors distrustful and IFRS complicates interpretation.	Adjustments can make investors distrustful of the measure.

Say on Pay

For many years, shareholders have delegated the questions related to compensation to the board of directors. After various scandals, the idea has spread that shareholders should have their rights back and vote on executive compensation.

In 2012, 16 out of 20 companies have included such a consultative vote during the Annual General Meeting of Shareholders, while back in 2005 no company had a consultative vote. According to our analysis, 2011 remuneration reports have been approved with a percentage ranging from 55% to 99%. In previous year, approval percentages ranged from 61% to 99% and only 15 out 20 SMI companies issued a consultative vote.

Only 14 of the 28 SMIM companies issued a consultative vote. The companies that did not implement such a vote are often "family" owned companies with no diversified shareholders.

Evolution of Swiss Legislation

2002	SIX Corporate Governance directive; Swiss Code of best practice for corporate governance
2007	Appendix to Swiss Code of best practice in relation to remuneration
2007	Article 663b bis & 663c of the Swiss Code of obligation (mandatory compensation and participation disclosure for listed companies)
2008	Minder Initiative against abuse salaries
2010	FINMA Circular 2010/01 on remuneration schemes (mandatory for large financial institutions)
2011	Swiss parliament draft direct and indirect counter projects to the Minder Initiative
2012	• Rejection of direct counter-proposal to Minder initiative • Approval of an indirect counter-proposal
2013	Submission of Minder Initiative to vote

SMI	Consultative vote?	Acceptance	% of acceptance
ABB	✓	✓	88.7%
Actelion	✓	✓	54.8%
Adecco	✓	✓	84.8%
Credit Suisse	✓	✓	67.6%
Geberit	✓	✓	91.1%
Givaudan	✓	✓	95.6%
Holcim	✓	✓	79.0%
Julius Bär	x	N/A	N/A
Nestlé	✓	✓	89.6%
Novartis	x	N/A	N/A
Richemont	✓	✓	N/A
Roche	✓	✓	98.5%
SGS	✓	✓	75.5%
Swatch	x	N/A	N/A
Swiss Re	✓	✓	80.7%
Swisscom	✓	✓	98.8%
Syngenta	✓	✓	86.5%
Transocean	✓	✓	85.5%
UBS	✓	✓	60.1%
Zurich	✓	✓	84.8%

SMIM	Consultative vote?	Acceptance	% of acceptance
Aryzta	✓	✓	87.3%
Baloise	x	N/A	N/A
Clariant	✓	✓	76.8%
Dufry	x	N/A	N/A
Fischer	✓	✓	90.3%
Galenica	✓	✓	90.0%
GAM	x	N/A	N/A
Helvetia Holding	x	N/A	N/A
Kuehne+Nagel	x	N/A	N/A
Lindt	x	N/A	N/A
Logitech	✓	✓	N/A
Lonza	✓	✓	95.9%
Meyer Burger	x	N/A	N/A
Nobel Biocare	✓	✓	91.6%
OC Oerlikon	✓	✓	89.8%
Pargesa Holding	x	N/A	N/A
Partners Group	✓	✓	N/A
PSP	x	N/A	N/A
Schindler	✓	✓	96.5%
Sika	x	N/A	N/A
Sonova	✓	✓	65.3%
Straumann	✓	✓	89.1%
Sulzer	✓	✓	76.5%
Swiss Life Holding	✓	N/A	N/A
Swiss Prime Site	x	N/A	N/A
Temenos	x	N/A	N/A
Valiant	✓	✓	91.8%

For many years, shareholders have delegated the questions related to compensation to the board of directors. After various scandals, the idea has spread that shareholders should have their rights back and vote on executive compensation.

Say on Pay in selected countries

Country	Year Adopted	Required or voluntary	Directors or Executives	Binding or Advisory	Frequency
UK	2003	Required	Directors	Advisory	Annually
The Netherlands	2004	Required	Executives	Binding	Upon changes
Sweden	2006	Required	Executives	Binding	Annually
Germany	2009	Voluntary	Executives	Advisory	Annually
USA	2011	Required	Executives	Advisory	Annually
Australia	2005	Required	Directors	Advisory	Annually

	Minder Initiative	Revision Swiss Code of Obligations
Compensation of the board of directors and of any advisory board	Aggregate compensation is subject to approval by shareholders on an annual basis. The shareholders' vote is mandatory and binding.	Same rule as the Minder Initiative.
Compensation of executive officers	Aggregate compensation is subject to shareholders' approval on an annual basis. The shareholders' vote is mandatory and binding.	Aggregate compensation is subject to an annual shareholders's vote. The articles of association state whether the vote is binding or of advisory nature.
Compensation regulation	Compensation schemes and plans must be included in the articles of association.	The principles applicable to the compensation of directors, executive officers and advisory board members are to be set out in a compensation regulation.
Severance payments and advance payments	Severance payments and advance payments are prohibited.	Severance payments and advance payments are prohibited unless they are in the interest of the company and approved by a two-third majority of shareholders on a case-by-case basis.
Election of board members	Board members are elected individually and on an annual basis,	Board members are elected individually and on an annual basis unless otherwise provided for in the articles of association (up to three years).
Election of the chairman of the board	The chairman is elected at the annual shareholder's meeting.	The chairman is elected by the shareholders unless otherwise provided for by the articles of association.
Proxy voting	Shareholder voting by proxy will continue to be permitted. However, the representation of shareholders by the company representative or depository banks is no longer permitted.	Same rule as the Minder Initiative.
Criminal sanctions	A breach of the above rules and principles will be subject to criminal sanctions.	There are no criminal sanctions for a breach of the rules on compensation regulation.

Looking ahead – future developments

In recent years, executive compensation has become a hot topic and a serious concern for stakeholders, as a result of legislative changes in Switzerland and worldwide and economic downturn in the past years. The say-on-pay movement, which gives corporate shareholders a stronger voice in setting executive pay, puts companies under pressure to set levels of remuneration that are aligned to the company structure, complexity, strategy and performance as well as with market conditions. Britain recently announced proposals for public companies to have to give shareholders a binding vote on compensation every three years. In the U.S., the Dodd-Frank financial reform law of 2010 also requires a shareholder vote on pay at least once every three years, but those votes are nonbinding. Back in Switzerland, the Minder Initiative launched in 2006 against abusive salaries requires that the shareholders' meeting votes on the global remuneration of management and the board of directors.

After years of heated discussions in an attempt to counter the Minder Initiative, the Swiss Parliament approved in March 2012 the final draft of a revision of the Swiss Code of obligations that closely follows the Minder Initiative but provides for a more balanced solution. Based on the Minder Initiative, the revision is intended to strengthen the position of the shareholders without going as far as the initiative. This legislative proposal, in the form of an indirect counterproposal, will only be published if the Minder Initiative is rejected by voters.

In addition to this indirect counterproposal, in May 2012, both Chambers of the Swiss Parliament voted in favour of a constitutional amendment (direct counterproposal) according to which compensation to members of the board, of advisory boards, executives or employees exceeding CHF 3 million per business year shall be added to the taxable profit of corporations and taxed accordingly. A vote on the direct counterproposal together with the Minder Initiative was expected to be held this year or in 2013. However, unexpectedly, the National Council (the lower chamber of the Swiss Parliament) rejected this direct counterproposal in a final vote held on June 15, 2012. Consequently, the Minder Initiative will be submitted to voters without a recommendation or a direct counterproposal from the Swiss Parliament in March 2013.

Appendices

Appendix – A comparison of Corporate Governance Codes

	Switzerland	UK	France
Code	Swiss Code of Best Practice for Corporate Governance (SCBP)	2012 UK Corporate Governance Code	The Corporate Governance of Listed Corporations (AFEP – MEDEF Code, April 2010)
Legal basis and compliance	*The purpose of the "Swiss Code" is to set out guidelines and recommendations, but not force Swiss companies into a straightjacket. Each company should retain the possibility of putting its own ideas on structuring and organization into practice.*	Disclosure (comply or explain)	Disclosure (comply or explain)
Separation of Chairman and CEO	**No** The Board of Directors should determine whether a single person (with joint responsibility) or two persons (with separate responsibility) should be appointed to the Chair of the Board of Directors and the top position of the Executive Management (sec. II e 18).	**Yes** The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board. (sec. A.2.1).	**No** It is essential for the shareholders and third parties to be fully informed of the choice made between separation of the offices of chairman and chief executive officer and maintenance of these positions as a single office (sec. 3.2).
Independence of Board Members/ Conflicts of Interest	Members of the Board of Directors should be persons with the abilities necessary to ensure an independent decision-making process in a critical exchange of ideas with the Executive Management. The majority of the Board should, as a rule, be composed of members who do not perform any line management function within the company (non-executivemembers) (sec. II b 12).	Half of the board (excluding the chairman) should be independent non-executives (sec. B.1.2). The company's annual report should identify which non-executive directors are considered to be independent. The board should determine whether a director is independent in character and judgment and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment (sec. B.1.1). Criteria: sec. B.1.1.	The independent directors should account for half the members of the Board in widely-held corporations and without controlling shareholders. In controlled companies, independent directors should account at least for a third. (sec. 8.2). A member of the board of directors, cannot be considered as independent if the latter has been a member of the management board within the last five years (sec. 8.4). Criteria: sec. 8.3.
Gender diversity quotas	**No**	**No** The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits and diversity on the board, including gender (sec.B.2). Initiative: Lord Davies report recommends that UK listed companies in the FTSE 100 should be aiming for a minimum of 25% female board member representation by 2015.	**Yes** Each board of directors should carefully consider what the appropriate balance within its membership should be. The objective is that a percentage of at least 20% of the board of directors of each company be composed of women within a three year period and that it then be increased to 40% (sec. 6.3).
Disclosure of diversity policy	**No**	**Yes** The annual report should include a description of the board's policy on diversity, including gender (B.2.4)	**No**
Binding say-on-pay vote	**No** The SCBP recommends that shareholders be involved in compensation decisions. An Initiative (Minder Initiative), subject to a popular vote in early 2013, requires the approval of board and executive compensation of Swiss listed companies by shareholders, as well as a ban on severance payments.	**No** Advisory vote (S439 UK Companies Act)	**No** Exclusive competence of the board of directors for the remuneration of the executive directors and the president of the board of directors (art. L.225-47, al. 1, art.L.225-53, al. 3 of the French Commercial Code). Allocation of director's compensation is set by the board of directors (sec. 18)
Disclosure of remuneration structure	**Yes** Disclosure of compensation and loans to directors and senior managers is a compulsory component of the annual financial statements, i.e. the Notes thereto (art. 663bbis and art. 663c para.3 SCO).	**Yes** There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. (Main Principle D.2).	**Yes** Art. 21.1. of the MEDEF Code recommends that all components of the remuneration of the executive directors shall be published immediately after the meeting of the board. (sec 21.1)

Germany	The Netherlands	Sweden
German Corporate Governance Code (most recently revised on May 2012)	The Dutch Corporate Governance Code (2008)	Swedish Code of Corporate Governance (February 1, 2010)
This Code includes recommendations, which are to be observed on a comply or explain basis and which are indicated by use of the word "shall"; Suggestions, which are optional and which are indicated by terms such as "should" or "can"; and passages which do not use these terms and which are mandatory under applicable law.	Disclosure (comply or explain)	Disclosure (comply or explain)
Yes The two-tier board envisioned by the German Code has a chairman of the Supervisory Board separate from the chairman of the Management Board (CEO). (sec. 5.4.4).	**Yes**	**Yes** The chief executive officer may be a member of the board but not its chair (sec II. 4).
At least one member of the supervisory board shall be independent (sec. 100 para. 5 AktG, sec. 263d German Commercial Code). A member of the supervisory board is considered independent if he/she has no business or personal relations with the company or its management board which causes a conflict of interest (sec. 5.4.2 sent. 2). The supervisory board shall have what it considers an adequate number of independent members (sec. 5.4.2 sent.1.).	All members of the supervisory board, with the exception of not more than one person, shall be independent within the meaning of the DCG Code (sec. III.2.1). Criteria: sec. III.2.2. The majority of the directors elected by the shareholders' meeting are to be independent of the company and its executive management.	A director's independence is to be determined by a general assessment of all factors that may give cause to question the individual's independence of the company or its executive management Criteria: (sec III. 4.4).
No When appointing the management board, the supervisory board shall respect diversity and, in particular, aim at an appropriate representation of women (sec. 5.1.2). Furthermore, diversity and in particular the representation of women in senior management shall be increased (sec. 4.1.5).	**Yes** The supervisory board shall aim for a diverse composition in terms of such factors as gender and age (principle III.3). The Act on Management and Supervision which is envisaged to enter into force on 1 January 2013 contains rule to enhance the participation of women. The bill aims to ensure that the composition of the board is balanced when at least 30% of its member is female (balance composition rule).	**No** The board is to have a composition appropriate to the company's operations, phase of development and other relevant circumstances. The board member selected by the shareholders' meeting are collectively to exhibit diversity and breadth of qualifications, experience and background. The company is to strive for equal gender distribution on the board (sec. III. 4.1).
Yes The concrete objectives regarding the composition of the Supervisory Board, including objectives of diversity, and the status of the implementation shall be published in the Corporate Governance Report (5.4.1).	**Yes** Non-compliance with the balanced composition rule must be explained in the company's annual report. (Act on management and supervision).	**No**
No	**Yes**	**Yes**
Yes Disclosure shall be made in a compensation report which as part of the Corporate Governance Report describes the compensation system for Management Board members in a generally understandable way (sec 4.2.5).	**Yes** The supervisory board shall prepare a remuneration report explaining the remuneration policy in clear terms and presenting the various components of the individual full remuneration of the members of the management board (sec. II.2.12 and II.2.13).	**Not covered**

Appendix – Hot topics for the board of directors and critical questions to ask

Impact of the state of the economy on operations and our financial results	Do we receive regular briefings on the state of the economy in the jurisdictions in which our company operates? Have we identified key indicators pertaining to our company and its markets to help us directly gauge how economic changes are affecting our organization? Do these indicators include those that enable the board to assess the economies' effect on suppliers, customers, and other partners?
Keeping risk and opportunity in balance	Do we take an appropriately balanced view of risk and opportunity? Are we too aggressive or too risk adverse when assessing opportunities? Do we have a "risk intelligent" culture within the boardroom and the management suite? Is the organization taking steps to embed that culture throughout our operations and business units? Does management keep the board apprised to the organization's key risk indicators and the steps being taken across the organization to mitigate those risks?
Are our strategic plans flexible enough to cope with changes ahead?	Do we monitor the effect that changing market conditions may have on our organization's strategy? Do we consider different scenarios and how those conditions would affect our ability to achieve our strategy? What processes does the company use to identify and evaluate changes in its operating environment? Are these findings reported to the board so the board can consider them when assessing strategy? Have we worked with management to set key performance indicators related to strategy, and does the board receive timely reports on them?
Involvement in operational management	Does our board play an appropriate role in the oversight of operational management and the execution of strategy? Do we receive reports on key performance indicators needed for us to understand the operational issues facing the organization and to guide the board's input into the development of short, medium, and long-term goals and objectives? Does our board receive regular reports on strategic and tactical operational matters, including those related to efficiency, effectiveness, performance benchmarks for competitors and other industries, customer satisfaction indices, and other reports on the execution of strategy?
Capital, cash and liquidity management	What potential financing risks does our organization face? Do our current cash reserves provide sufficient protection from these risks? Is our company making the best use of its cash in hand? If we are continuing to accumulate cash holdings by keeping costs out of the business, is that strategy putting our longer-term viability at risk? Are we making sufficient reinvestments in our business?
Merger and acquisition opportunities	Have we considered the position of our organization? Are we an acquirer or more likely to be the target of one? Has the board reviewed and approved a proactive M&A strategy for the organization? Does it include both offensive and defensive game plans? Has the board developed a strategy for communicating the details of a proposed transaction to the organization's stakeholders?
Do we have the optimal organisational structure	Do we fully understand all of the risks that extend across the company globally? Are we confident that our outsourcing providers and strategic partners are identifying and mitigating the risks they face? Are we providing regular oversight of the global control structure? Are we satisfied that our organizational values are relevant to everyone and are shared and supported across our multicultural environment? Are our network partners' values consistent with our values? How well does our organization adapt to process changes? Do employees have sufficient time and support to learn and become comfortable with new methods and processes in order to achieve expected efficiency improvements?
Talent management	Does the board understand all of the strategic and risk implications associated with our organization's people and the development of talent? Does our organization truly view people as a strategic asset and are we taking appropriate steps to ensure the renewal of our talent resources? How well do leaders in our organization understand the capabilities and aspirations of their teams? Do they spend sufficient time helping their people set goals and providing feedback and coaching to enable meaningful development?
Sustainability and corporate social responsibility	Does our organization have a sustainability vision and strategy supported by suitable sustainability policies? Have they been reviewed and approved by the board? Does the board understand the sustainability opportunities and the sustainability risks, not just to the organization but also to directors? Has the organization carried out a sustainability risk analysis? What are the organization's policies regarding setting goals and measuring performance in economic, environmental, and social areas? What information is disclosed on sustainability issues, and is the board required to review and approve those disclosures?
Regulation and compliance	Are we aware of all the proposed new regulations affecting our organization and the cost of their implementation? Have we determined the board's role in implementing the new rules, and how the new regulations may affect the board? Has our organization adopted a proactive approach that would enable us to manage the implementation of new rules as a portfolio, instead of having to respond to each new requirement as it arises? Have we built strong relationships with key regulators? Are we liaising with them to gain a better and earlier understanding of the new rules that may affect our organization?
Transparency in corporate governance	Has the board developed and disclosed to shareholders a clear written policy that outlines the practices the board will follow to engage shareholders? Does the board understand the expectations that shareholders and other stakeholders have in terms of the topics and level of detail they expect in communications from the company and the board? Do our reports and other disclosures clearly present the position of the company and the board in language that is straightforward, easy to understand, and free of unnecessary technical jargon?
Board performance	Do we have a clear development plan for the board and individual directors? Do we conduct annual assessments of the board, its committees and individual directors, and do we incorporate the findings of these assessments into our board development plan? Are we confident that the board, as a whole, has the right mix of knowledge and experience to be able to address all of the board's responsibilities effectively? Are we able to devote sufficient time to each area of responsibility? Have some directors or committees become overburdened with new responsibilities they may have been required to take on in recent years?

Notes

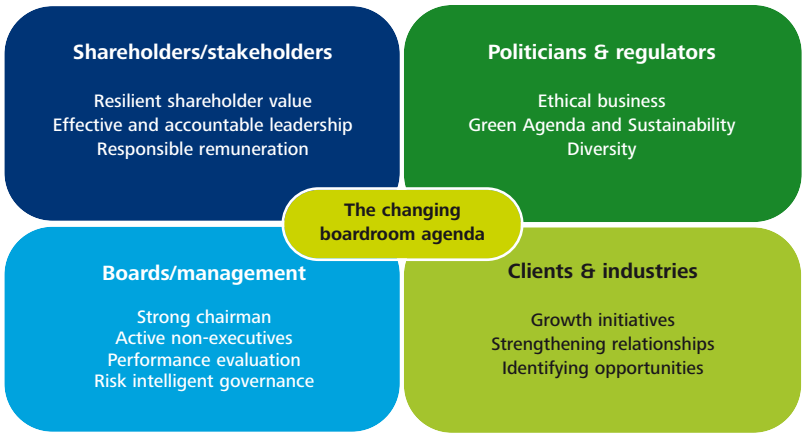
How Deloitte can help ?

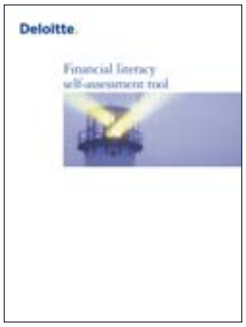
Deloitte can assist you in dealing with the issues and topics discussed in this survey. Deloitte has worked with many of the biggest and best companies in the world. We provide services that help our clients deliver on their goals and aspirations. With in the region of 200,000 people globally we have a great and diverse community of experts to draw upon to serve our clients. We have expertise in all the areas covered by this survey and have worked with boards and executive committees to ensure that they can address many of the challenges highlighted here. Here are some of the many examples :

- We have undertaken board effectiveness assessments and recommended improvements to help the board function better.
- Our risk teams have assisted companies to develop their risk management frameworks and establish risk committee structures.
- Our audit professionals have worked with clients to ensure that audit committees and audit functions are operating effectively.
- We have assisted clients to establish robust fraud management frameworks and undertaken investigations into events or when things have gone wrong.

Corporate governance

Our approach to understanding whether companies' governance arrangements serve them well, and whether they will withstand scrutiny considers the 4 key areas below:





Our broad range of services includes:

- Performance evaluation
- Financial literacy tools
- Director awareness and training
- Technical training for non-executives and executives
- Governance health checks
- Risk governance and management

Remuneration is a key topic at the moment. We have an executive compensation team that has supported clients to ensure they have schemes that meet their requirements whilst addressing the emerging best practice.

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