

SWISS PROXY SEASON

DID “SAY ON PAY” MOVE THE NEEDLE?



At the 2015 AGMs investors would be able to vote for the first time on the aggregate amount compensation for the management and the supervisory board members. The law changes are expected to result in a different compensation structure in the Swiss index for the most recent financial year.

This report aims at providing substantial insights, on a seven-year time span (2008-2014), of compensation practices across the twenty largest firms in Switzerland. It shows the yield for investors in relation to the CEO's pay of the SMI companies. The report contains an independent screen on companies pay for performance alignment, based on returns realized to shareholders, using TSR as the measurement, in relation to the compensation value actually received by the CEO which is realized pay¹. We believe that this results in better insight on the relationship between pay and shareholder value delivered instead of assessing against granted² compensation. Furthermore, the report provides a ranking of the 2014 highest paid CEOs, the leading key performance indicators and the change in the CEO compensation structure.

INTRODUCTION

On the 3rd of March 2013, 67.9% of the Swiss citizens went to the national polling places and voted against the "rip-off salaries". The rebellious spirit of Thomas Minder spread across whole Switzerland and ended up in the Ordinance against Excessive Pay. As a consequence, Switzerland has introduced new corporate governance practices effective as of the 1st of January 2014. At first, the new legislation

contains a binding annual (re-)election of non-executive directors.

Additionally, the new legal requirements promote an increased transparency in the executives' pay packages through the annual advisory approval of the compensation reports at the AGMs. Moreover, the code includes a provision against excessive golden parachutes.

"SWISS SHAREHOLDER 'SAY ON PAY' VOTE DID NOT RESET CEO PAY"

KEY FINDINGS

- For 2014 investors in the SMI got returns of **9,5%**, the index price rose by **62%** from 2008.
- The average realized CEO Pay slightly increased over the last few years and shows a growth of 36% from 2008.
- A significant portion of the SMI shows misalignment between pay and performance. Measuring the alignment on a 1 year basis this equates to 40% and on a 3year period 35%.
- The **best paid CEO** for 2014 was Richard Lepeu from Com. Financiere Richemont; in 2013 it was Severin Schwan from Roche Holding LTD.
- A shift in balancing compensation more in to variable incentives though with a decrease in long term incentives. Pay ratio short- vs. long-term incentive awards shifted from 1,07 to 1,18. Long Terms Incentives (LTI) decreased from 48% to 45% of total variable pay from 2008 to 2014.
- Over the years, the fixed components accounted for around half of the realized pay packages.
- Top 3 leading key performance indicators applied across the SMI for short and long term incentives are relative TSR, economic profit and EPS.

¹ *Realized pay*: the sum of total paid and received compensation including the value of shares/options vesting in the year of financial statement.

² *Granted compensation*: the total value of compensation awarded in the year of financial statement including the estimated the long term value of shares/options granted in the year of financial statement.

**“REBALANCING
TOWARDS STI: A SIGN
FOR GOVERNANCE
RISK? FAILING TO
ALIGN LONG-TERM
INCENTIVES WITH
SHAREHOLDERS’
INTERESTS”**



OVERVIEW

Despite the financial crisis and the disruption on the stock markets, the SMI grew by more than 37% on a 5-years basis. The lowest index price was in 2011, which brought the 3-years holdings a value increase of over 50%. The 1-year yield from 2013 to 2014 amounted to 9,5%.

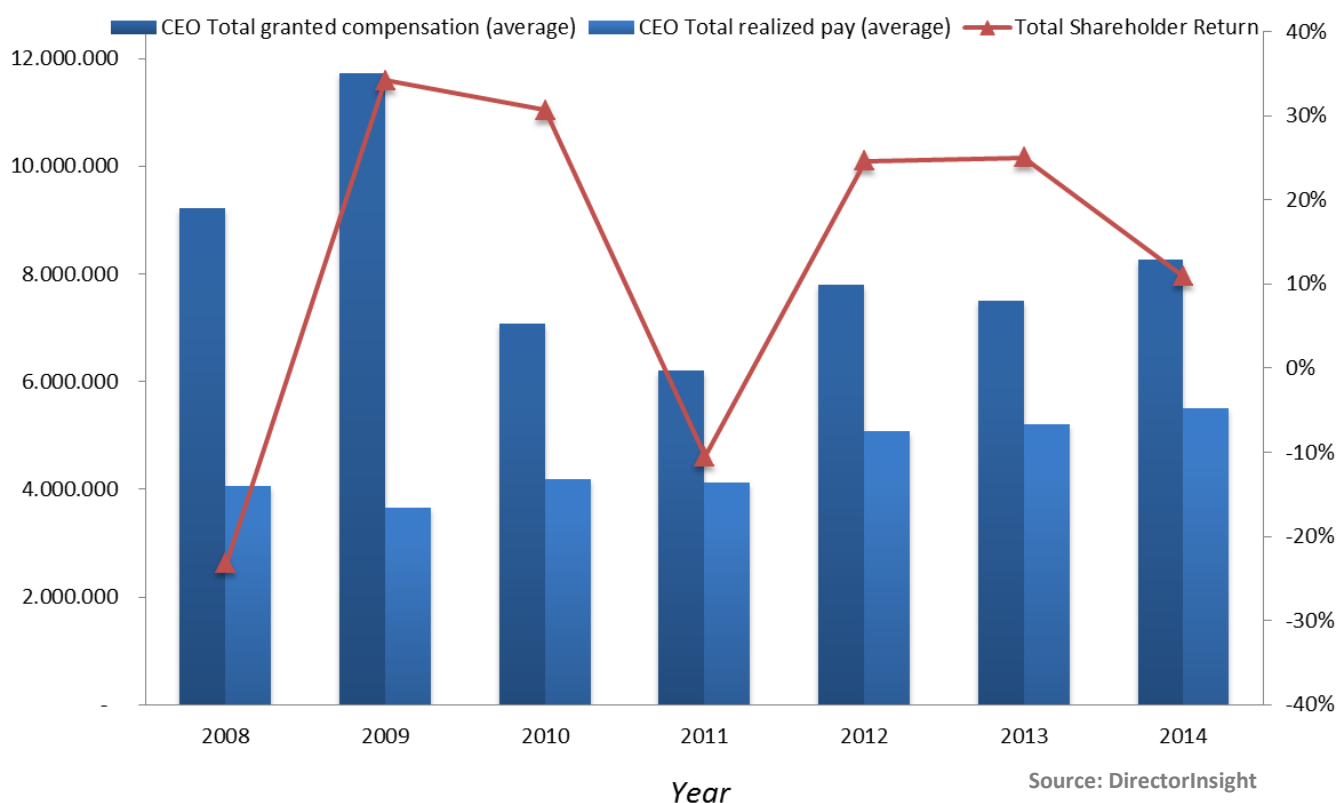
Best performer in absolute terms was Actelion LTD, bringing 58% annual returns for its shareholders in 2014. Successful in the past year were also Givaudan S.A., Novartis AG, Geberit AG, and Zurich Insurance Group AG. In relative terms the top performers of the index are again Zurich Insurance Group and Givaudan, which grew significantly, compared to the previous year.

“CEO PAY HAS BEEN ON THE RISE SINCE 2011 AGAINST A VOLATILE TSR”






The graph below provides evidence for the development of the TSR of the index on a year-to-year basis and the absolute average granted and realized pay.

CEO pay in 2011 declined by a lower percentage than the overall drop on the financial market. In the recovery year of 2012 the TSR rose by 32,7% and CEO pay increased by 23%.

The SMI 2014 TSR dropped with 15 percentage points against 2013 while the pay of Swiss CEO's continues to rise.



Best and worst paid CEO

	Individual		Company	2014 Total Realized Remuneration in Millions (CHF)	2014 Total Shareholder Return
TOP 3 BEST PAID CEO	Richard Lepeu		Com. Financiere Richemont	17,7	4%
	Joseph Jimenez		Novartis	13,9	37%
	Paul Bulcke		Nestlé	8,7	18%
MIDDLE RANGE	Bernard Fontana		Holcim	4,3	11%
WORST PAID CEO	Urs Schaeppi		Swisscom	1,6	18%

Source: DirectorInsight

The top three paying companies, ranked from highest to lowest, were Com. Financiere Richemont, Novartis AG and Nestlé S.A.,

In 2014 Mr. Richard Lepeu, Co-CEO of Com. Financiere Richemont received a grand total of 17.7 million CHF and Novartis AG and Nestlé AG paid their CEO's an annual compensation of 13.9 and 8.7 million CHF, respectively. The pay of Mr. Joseph Jimenez, top manager of Novartis AG, increased with 311% versus 2013 due to the vesting of 111.171 shares from Novartis 2012-2014 OLTPP scheme at a value of 9.47 million CHF. The latter included a share price appreciation over the vesting period of 3,4 million CHF. Novartis AG and Nestlé AG also represent the largest index weights, which are used as a proxy to measure firm size. Out of the three companies, Com. Financiere Richemont, the highest paying company, ranked the lowest (4%) relative to Novartis AG and Nestlé AG that constituted index weights of 19.46% and 20.28%, respectively.

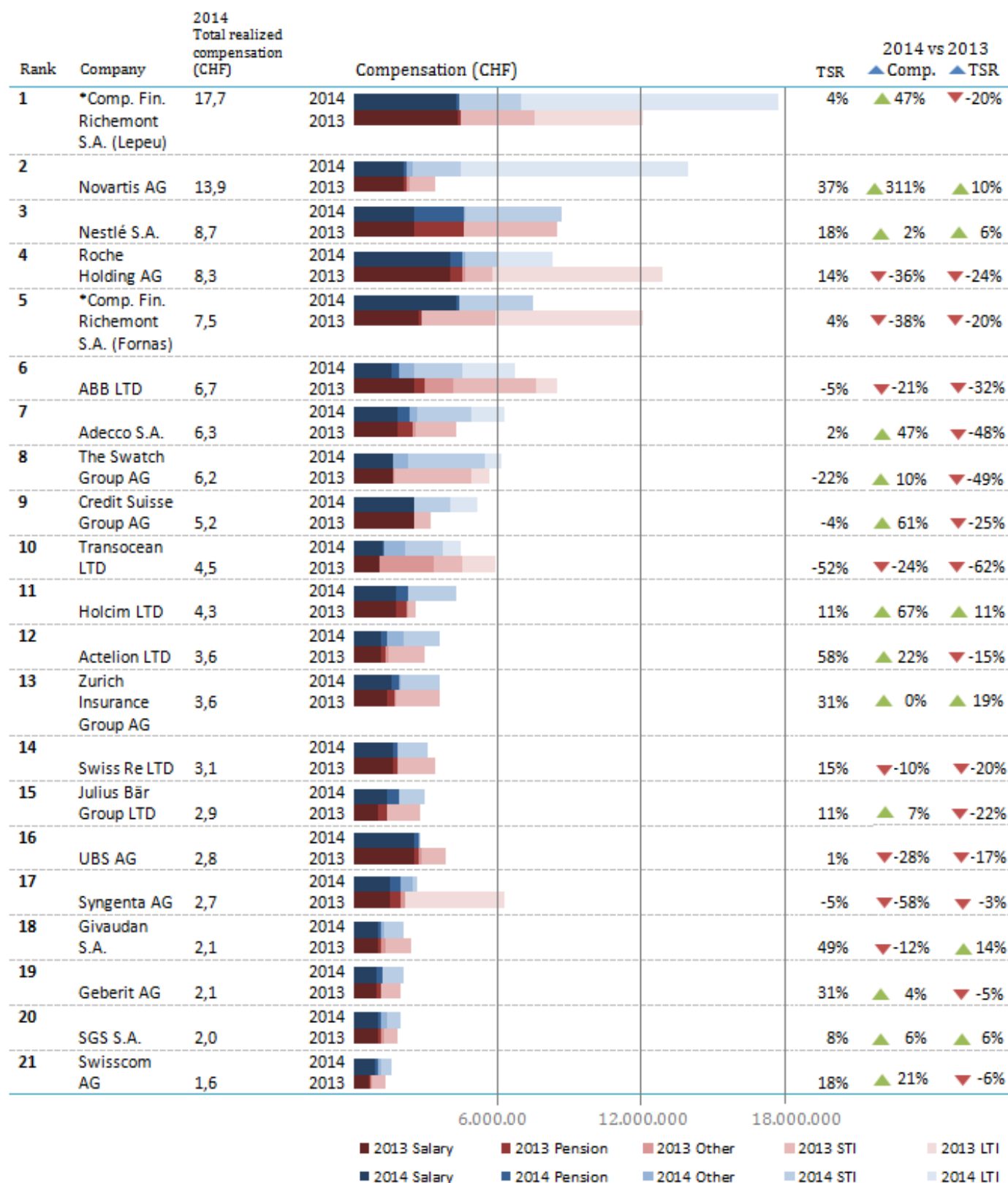
An interesting case in the middle range is the compensation package of Holcim CEO Bernard Fontana. In terms of relative salary changes, Holcim LTD was distinguished for having the second highest CEO salary increase in the index.

Whilst not being one of top paid executives in the index, Mr. Fontana represented a significant compensation increase relative to the previous year; nearly reaching the 70% mark. The significant increase in the remuneration paid by Holcim LTD is attributed to the increase in the short- and long-term variable components.

On the lowest end Urs Schaeppi for Swisscom could be found. Unsurprisingly for the telecommunication business his total salary was more than 11 times lower than the one of the most valued Swiss executive.

The chart on the next page shows a ranking of 2014 pay of CEO's within the SMI, the value created for shareholders based on the performance of the company TSR and the growth of both components versus the previous year. It enables you to quickly assess the correlation between the company CEO pay and performance.

Overall, it appears that the very few of the companies made an effort to adjust the CEO remuneration according to their stock performance on a year-to year basis.



*Comp. Fin. RICHEMONT has 2 Co-CEOs

Source: DirectorInsight

PAY FOR PERFORMANCE

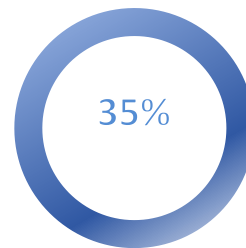
When you compare each of the SMI companies versus all the twenty companies in the index, we find that over a 1 year period 40% of the companies show a pay for performance misalignment and 35% over a 3 year measurement period.

The charts below demonstrate a relative comparison by plotting the company's percentile ranking of their realized pay against their respective TSR percentile ranking

The companies plotted in the shaded gray area represent a pay for performance alignment. Both, on a one year and three year period, UBS, Holcim, Julius Baer and Novartis show good corporate governance practices.

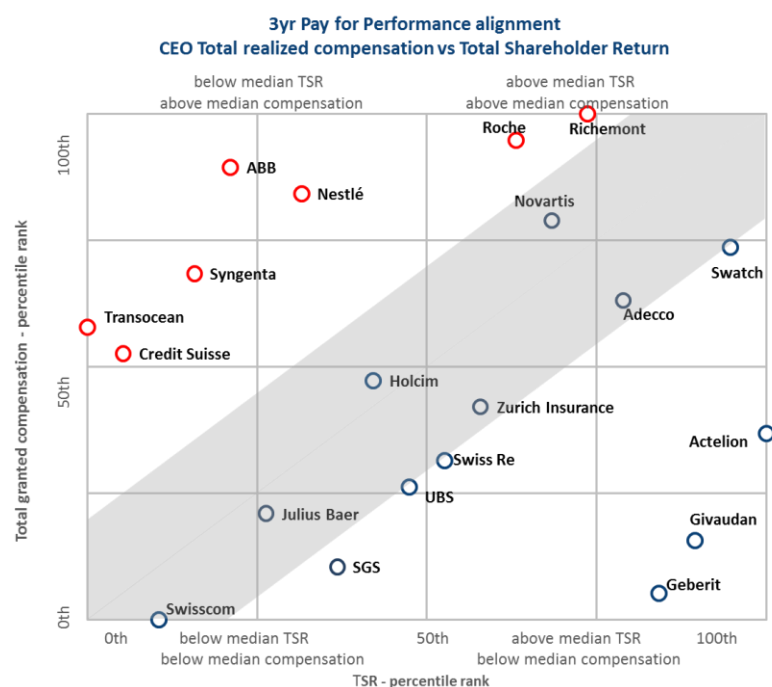
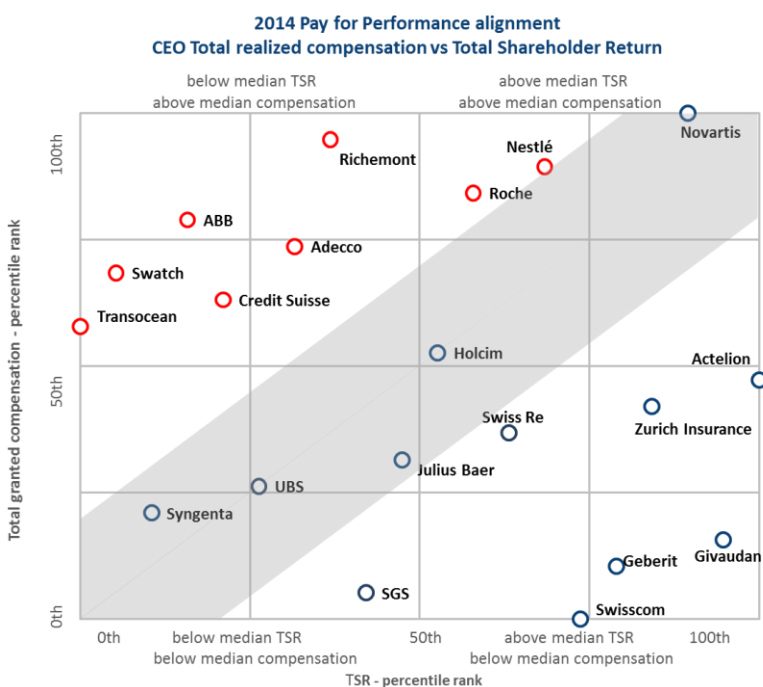
The companies above the grey area show a misalignment. They appear to be overpaying their CEOs relative to their shareholder return. Relative to the SMI, Syngenta shows a good alignment on a 1 year basis but a misalignment on a longer period.

Majority of the companies showing a misalignment on a 1 year basis continue to show poor alignment on a 3 year basis, except Adecco and Swatch. These two companies show a strong pay for performance alignment over a 3 year period. In addition, one should mention the extreme case of Transocean being the worst performing company in the index and paying the CEO above the median.



"A DISCONNECT IN CEO PAY VERSUS SHAREHOLDER RETURN"

On the right down corner of the graph, the companies which apply a more conservative pay practice could be found. For instance Givaudan and Geberit delivered high returns for their shareholders but stayed in the lower range of CEO pay, both short and long term.



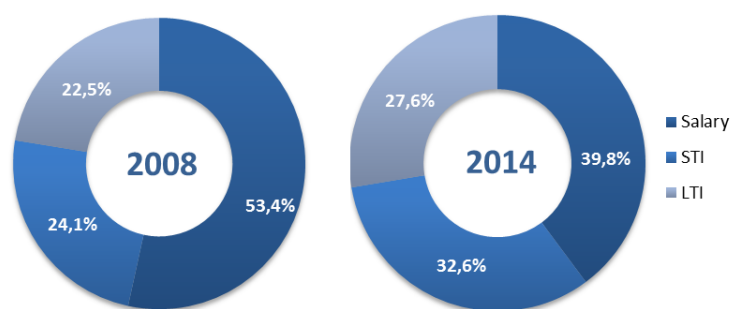
FIXED VERSUS VARIABLE, SHORT-TERM VERSUS LONG-TERM

In order to compare the structures of the pay packages one should notice that the average CEO realized pay increased from 4.1 million CHF in 2008 to 5.5 million CHF in 2014. Over this period we see that the CEO pay structure has been slightly rebalanced. The proportion of the fixed pay of the whole compensation decreased throughout the years while variable pay increased from 46% to 60% of total compensation. The long-term component of the variable pay accounted for around one-fifth of the CEO's pay in 2008, its proportion increased to slightly above one-quarter in 2014. However, the pay ratio between short- and long-term variable pay changed from 2008 to 2014, with a shift in more short-term instead of long-term. The trend of decline suggests that the companies substituted packages with multi-year performance evaluation with annual bonuses. Taken together, it could be perceived that only circa 45% of the CEO variable pay is at risk over a longer period and evidently emphasizes short-termism still being reflected in the CEO's variable pay.

LEADING PERFORMANCE INDICATORS

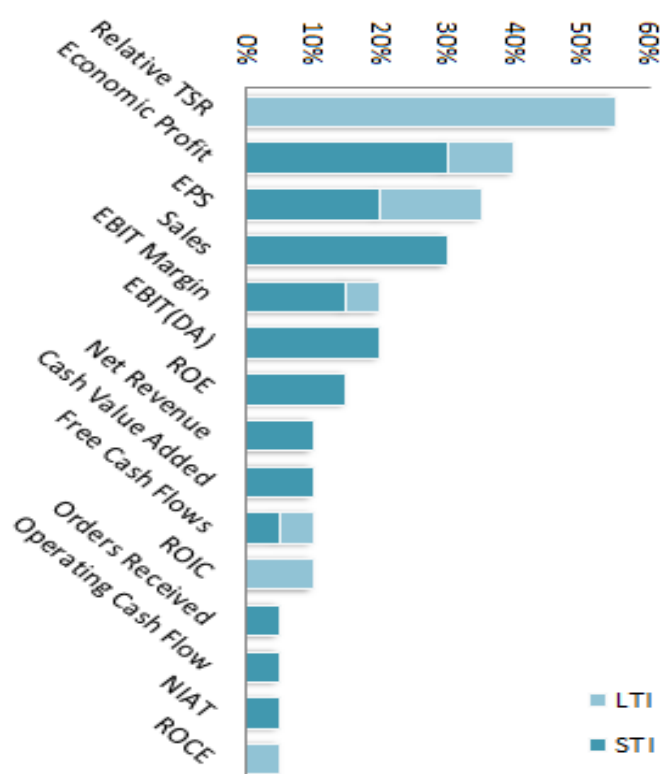
A substantial portion of CEO pay is tied to company financial and operational performance results. For 2014, the SMI companies mainly relied on the relative TSR as a performance measure for their variable components. Eleven firms of the index used the TSR compared to peers for their LTI plans. Worth mentioning are the economic profit and EPS key performance indicators, which are favored metrics for both STI and LTI plans. Additionally, between 30% and 20% decided to implement plans depended on the accounting figures Sales, EBIT (DA) and EBIT

margin. The Net Income after Taxes and the Return on Capital Employed could be seen as rather exotic measures in the SMI index, being used by only 5% of all 20 firms.



Source: DirectorInsight

"TSR STILL SHOWS AS THE MAIN PERFORMANCE INDICATOR FOR LONG TERM INCENTIVE PLANS"



Source: DirectorInsight

CONCLUSION

To wrap it up, despite the fact that shareholders have been given the right to vote on pay, to mitigate excessive pay levels and governance risks, last proxy season voting outcomes shows there is still potential in front the Swiss companies to improve their corporate governance practices and for shareholders to obtain a better understanding.

The remuneration plans in the SMI are still not dynamic enough to ensure that CEO Pay is aligned with long term shareholder value creation. It is fair to say that companies have restructured their CEO pay with proportionally more pay at risk. Though not sufficiently, as significant portion of their variables pay is tied to short term actions, with the risk that those executives reap the rewards of their actions before their full effect is materialized.

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Company description



AMA Partners, specialists in executive pay, corporate governance and financial performance.

All data is sourced from DirectorInsight, AMA Partners. An easy

to access on line platform with comprehensive, fundamental company financial performance and executive compensation data from 2008 and onwards, providing highest quality statistics and data for assessing executive compensation levels, pay for performance alignment, board intelligence and corporate governance practices. Data covers over 31 indexes, 1150 listed companies with circa 30.000 senior executives, drawn from leading European equity indexes. DirectorInsight provides a fully integrated platform where boards, remuneration committees, investors and professionals in the field of HR and research, have access to the same data, to make informed decisions and engage effectively.

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