

Panel Meeting: Compensation Disclosure

Dr. Stephan Hostettler,
Managing Partner
stephan.hostettler@hostettler.org



Rodolfo Straub,
Head of Admission
rodolfo.straub@swx.com



Prof. Dr. Rolf Watter,
Attorney at Law
r.watter@baerkarrer.ch



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Zunfthaus zur Meisen

Panel Meeting: Compensation Disclosure

Rodolfo Straub,
Head of Admission



Panel Meeting: Compensation Disclosure

Regulation of the SIX Swiss Exchange

“Old” Swiss Code of Obligations:

- No explicit rule
- Controversial, whether shareholders have right to be informed in regard of compensation for board of directors

“Old” Directive on Information relating to Corporate Governance (DCG; ref. no. 5):

- Mandatory disclosure of compensation for board of directors (globally; amount for highest paid individual) and senior management (globally)
- Place of publication: Separate section of annual report
- Enforcement:
Sanctions accordingly to article 82 et seq. Listing Rules – several published sanctions

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Regulation of the SIX Swiss Exchange

New article 663b^{bis} Swiss Code of Obligations:

- Mandatory disclosure of compensation for board of directors (individually), senior management (globally, amount for highest paid individual) and members of the advisory board (individually)
- Place of publication: Notes to the balance sheet
- Audited
- Enforcement:
no explicit sanctions but approval of financial statement and release of members of board of directors by general assembly, liability of board of directors and auditors etc.

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Regulation of the SIX Swiss Exchange

New DCG (ref. no. 5):

- Basic principles and elements of compensation and shareholding programs of acting and former members of the issuer's board of Directors and senior management as well as the authority and procedure for determining such
- Place of publication: Separate section of annual report
- Not audited
- Enforcement:
Sanctions accordingly to article 82 et seq. Listing Rules
– several published sanctions

www.swx.com/admission/being_public/governance_en.html

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Regulation of the SIX Swiss Exchange

Problems in regard to enforcement of rev. no. 5 DCG by SIX Swiss Exchange:

- difficult to investigate whether disclosure is correct

Panel Meeting: Compensation Disclosure

Regulation of the SIX Swiss Exchange

Role for SIX Swiss Exchange in regard of the disclosure of compensations?

- Compliance in regard with Art. 663b^{bis} CO:
Surveillance and sanctioning by SIX Swiss Exchange?
- Review of the adequacy of compensation and shareholding programs by SIX Swiss Exchange?

Precondition:

If yes, new procedures of investigation and new forms of enforcement have to be provided in favour of SIX Swiss Exchange by legislator

Panel Meeting: Compensation Disclosure

Prof. Dr. Rolf Watter,
Attorney at Law



Legal Aspects

New Disclosure Rules (since January 1, 2007)

- Art. 663b^{bis} Para 1 CO
- Art. 5.1 Directive on Information Relating to Corporate Governance
- Annex I Swiss Code of best practice
- Art. 663b^{bis} Para 3 CO
- Art. 663b^{bis} Para 4 CO
- Art. 663c Para 3 CO
- Companies, whose shares are listed have to disclose all **compensation benefits** paid directly or indirectly to present or past members of the board, management, advisory boards and to related parties;
- All outstanding **loans** and **credits** granted to the above parties must be disclosed as well;
- Level of detail: all amounts for **each** board member and the **highest amount** given to a manager (normally CEO), management otherwise in aggregate. Compensation has to be broken down into its components;
- In addition, **shareholdings** (including derivatives) have to be disclosed individually

Legal Aspects

New Disclosure Rules (Board of directors)

Watter, Rolf / Maizar, Karim
 Offenlegung von Vergütungen
 und Beteiligungen bei
 Schweizerischen
 Publikumsgesellschaften
 gemäss OR, Kommentar zu
 Art. 663b^{bis} und 663c OR,
 Vorabdruck aus dem Basler
 Kommentar zum OR II, Art.
 663b^{bis} N 114.

	President		Member		Total of the Board		Related parties	
	Year 2	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2	Year 1
1. Compensation								
1.1 Cash								
fixed component	40000	35000	30000	30000	70000	65000		
variable								
1.2 Shares / Options								
Shares (fix)	10000	2000	7500	1000	17500	3000		
Options (variable)								
1.3 Benefit in kind								
Car / subscriptions	8000	8000			8000	8000		
1.4 Other Expenses								
Pension fund and social security	11600	9000	8200	3450	19800	12450		
Contribution for health and accident insurance	1000	1000	1000	1000	2000	2000		
1.5 Additional remuneration								
Legal advice			20000	5000	20000	5000		
1.6 Securities granted								
Guarantees	5000	0			5000	0		
Total Compensation	75600	55000	66700	40450	142300	95450		
2. Loans / credits								
2.1 Loans							50000	
Total Loans / Credits							50000	

Legal Aspects

New Disclosure Rules (Management)

Watter, Rolf / Maizar, Karim
 Offenlegung von Vergütungen
 und Beteiligungen bei
 Schweizerischen
 Publikumsgesellschaften
 gemäss OR, Kommentar zu
 Art. 663b^{bis} und 663c OR,
 Vorabdruck aus dem Basler
 Kommentar zum OR II, Art.
 663b^{bis} N 114.

1. Compensation				
1.1 Bar- / Book money				
fixed component	200000	180000	1800000	1500000
variable	350000	250000	2500000	2000000
1.2 Shares / Options				
Shares (fix)	100000	80000	800000	600000
Options (variable)	100000	80000	800000	600000
1.3 Benefit in kind				
Car / memberships	30000	25000	190000	150000
1.4 Expenses for provisions				
Contribution for pension fund	95000	80000	600000	500000
Contribution for health and accident insurance	20000	15000	140000	100000
1.5 Termination payments				
			300000	0
Total Compensation	895000	710000	7130000	5450000
2. Loans / credits				
2.1 Loans				200000 0
Total Loans / Credits				200000 0

Legal Aspects

New Disclosure Rules (Participations)

Watter, Rolf / Maizar, Karim
 Offenlegung von Vergütungen
 und Beteiligungen bei
 Schweizerischen
 Publikumsgesellschaften
 gemäss OR, Kommentar zu
 Art. 663b^{bis} und 663c OR,
 Vorabdruck aus dem Basler
 Kommentar zum OR II, Art.
 663c N 70.

	Number of shares		Number of conversion rights		Number of option rights		Other financial instruments	
	Year 2	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2	Year 1
President	800000 (2.7%)	750000 (2.5%)			30000 (<0.1%)	0		
Member of the board I	30000 (<0.1%)	800000 (0.1%)	2000 (<0.1%)	0	50000 (<0.1%)	0		
Member of the board II	20000 (<0.1%)	10000 (<0.1%)			50000 (<0.1%)	0		
Member of the management CEO	145000 (0.5%)	80000 (<0.3%)			60000 (<0.2%) 30000 (<0.1%)	0	1	0
Member of the management CFO	130000 (0.4%)	70000 (<0.2%)			40000 (0.1%) 20000 (<0.1%)	0		
Member of the management COO	100000 (0.3%)	60000 (<0.2%)			40000 (<0.1%)	0		

Legal Aspects

Case Study (Clariant)

Clariant, Annual Report 2006, p. 73 et seq., p. 127 et seq.

Clariant Annual Report 2007, p. 82 et seq., p. 160 et seq.

Annual Report 2006

Annual Report 2007

Annual Report 2006

In General/Compensation/Loans:

Comparison to previous year ✓

Individual disclosure ✗

Separate overall total for Executive Board ✗

Break-up fix and variable benefits ✗

Valuation of the securities granted ✗

Indication of valuation method ✗

Disclosure of loans ✓

Annual Report 2007

In General/Compensation/Loans:

Comparison to previous year ✗

Individual disclosure ✓

Separate overall total for Executive Board ✓

Break-up fix and variable benefits ✓

Valuation of the securities granted ✓

Indication of valuation method ✓

Disclosure of loans ✓

Legal Aspects

Case Study (Clariant)

Clariant, Annual Report 2006, p. 73 et seq., p. 127 et seq.

Clariant Annual Report 2007, p. 82 et seq., p. 160 et seq.

Annual Report 2006

Annual Report 2007

Annual Report 2006

Participations & options/conversion rights:

Individual disclosure ✘

Indication of valuation method ✘

Percentage participations/voting rights ✘

Annual Report 2007

Participations & options/conversion rights:

Individual persons ✓

Indication of valuation method ✓

Percentage participations/voting rights ✘

Legal Aspects

Case Study (Swatch)

Swatch, Annual Report 2006, p. 134 et seq., p. 182 et seq.

Swatch Annual Report 2007, p. 138 et seq., p. 192 et seq.

Annual Report 2006

Annual Report 2007

Annual Report 2006

In General/Compensation/Loans:
Comparison to previous year ✓

Individual disclosure ✗

Separate overall total for Executive Board ✗

Break-up fix and variable benefits ✗

Valuation of the securities granted ✗

Indication of valuation method ✗

Disclosure of loans ✓

Annual Report 2007

In General/Compensation/Loans:
Comparison to previous year ✓

Individual disclosure ✓

Separate overall total for Executive Board ✓

Break-up fix and variable benefits ✓

Valuation of the securities granted ✓

Indication of valuation method ✓

Disclosure of loans ✓

Legal Aspects

Case Study (Swatch)

Swatch, Annual Report 2006, p. 134 et seq., p. 182 et seq.

Swatch Annual Report 2007, p. 138 et seq., p. 192 et seq.

Annual Report 2006

Annual Report 2007

Annual Report 2006

Participations & options/conversion rights:

Individual disclosure ✘

Indication of valuation method ✘

Percentage participations/ voting rights ✘

Annual Report 2007

Participations & options/conversion rights:

Individual disclosure ✔

Indication of valuation method ✔

Percentage participations/ voting rights ✘

Legal Aspects

PWC Study: Compensation & Disclosure (1/3)

PricewaterhouseCoopers, Executive Compensation & Disclosure, October 2008, <http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_executive_compensation_disclosure_08_e.pdf>, p. 7, p. 8.

Breakdown

- All companies reviewed broke down their compensation elements in at least three components, i.e. "cash", "equity", "other"
- Many companies additionally disclose **contributions** to pension plans and fringe benefits separately;
- Some companies went beyond that and disclosed **benefits** such as company cars and health insurance allowances

Individual Disclosure

- All companies comply with the individual disclosure requirements
- Some companies have disclosed **individual compensation** of Executive Board members on a voluntary basis



Clariant: Base salary, Cash Bonus, Sharebased bonus, Benefits

Swatch: Cash, Bonus, Share & Optionbased bonus, others



Clariant: not disclosed

Swatch: not disclosed

Legal Aspects

PWC Study: Compensation & Disclosure (2/3)

PricewaterhouseCoopers, Executive Compensation & Disclosure, October 2008, <http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_executive_compensation_disclosure_08_e.pdf>, p. 9, p. 10.

Indication of calculation methods

- Some companies state the amount of equity based compensation **without explaining** how this has been calculated
- Other companies **clearly describe** the characteristics of their equity instruments and which parameters they used to determine the value of the granted instruments

Severance Pay

- 70% of the annual reports do not indicate whether severance payments had been made or not
- Only four of 54 companies disclosed **individual information** on the amount and the recipient of the payments
- 57% of the companies disclosed information on **contractual agreements** pertaining to severance payments

Clariant: Shareprice is the Average of the three trading days within the 2nd week of January (CHF 19.15)

Swatch: Tax value (exercisable 2007); Black-Schooles-Method (exercisable 2008/2009)

Clariant: 4.02 Mio. had been paid. 12 or 24 months of total compensation (change of control)

Swatch: No severance payments made. In case of contract-termination: No severance pay

Legal Aspects

PWC Study: Compensation & Disclosure (3/3)

PricewaterhouseCoopers, Executive Compensation & Disclosure, October 2008, http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_executive_compensation_disclosure_08_e.pdf, p. 11, p. 12.

Share Ownership and Participation Rights

- Only few companies provide comprehensive information regarding the **terms and conditions** of the participation rights (option terms, exercise price, vesting conditions)

Clariant: All mentioned information are disclosed

Swatch: Vesting conditions are not disclosed

Comparative Information

- 74% of the companies provided comparative information for years proceeding in the annual reports
- 65% of the companies **broke the comparison down** in Board of Directors and Executive Board
- 18% disclosed the comparison on an **individual** basis

Clariant: No comparative information disclosed

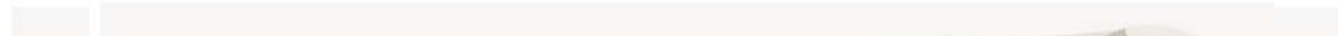
Swatch: Comparative information disclosed but without breakdown

Legal Aspects

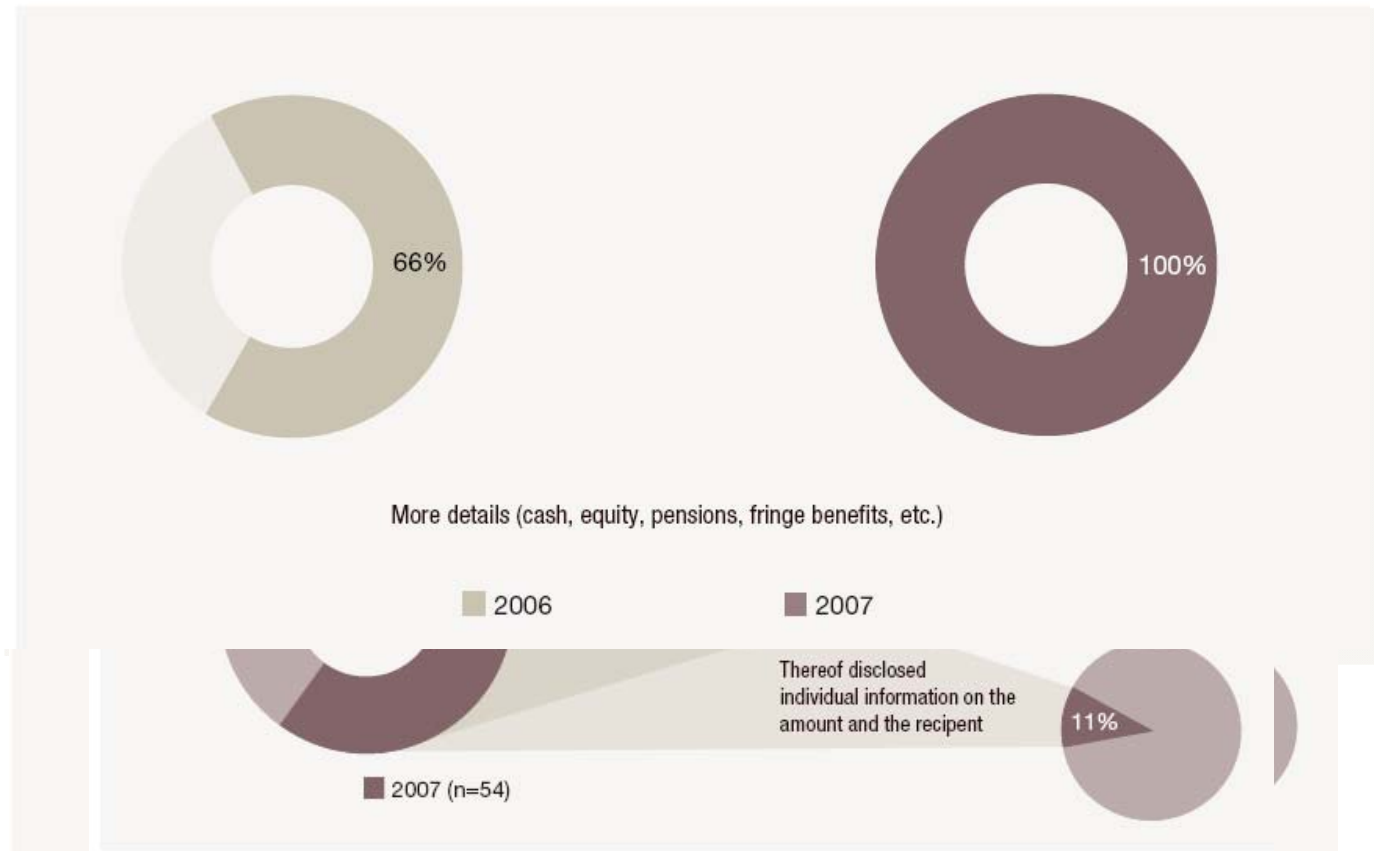
Graphics of PWC Study

PricewaterhouseCoopers, Executive Compensation & Disclosure, October 2008, http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_executive_compensation_disclosure_08_e.pdf, p. 7 et seq.

Company Disclosure regarding Severance Payments



Breakdown of Compensation Elements



Legal Aspects

Conclusion and future issues (1/2)

- The analyzed companies disclose their compensation, participation and options/conversion rights of the individuals (Board and Management)
- Both companies separate between fix and variable emolument (cash / shares, resp. options)
- The companies indicate the valuation of the shares and options:
 - Clariant*: Average of three trading days within 2nd week of January
 - Swatch*: Exercisable 2007 = tax value
Exercisable 2008/2009 = Black-Schooles-Method
- Swatch compared the compensations with the preceding year. Clariant did not disclose comparative information
- Both companies do not disclose the percentage of the participations

Legal Aspects

Conclusion and future issues (2/2)

- Altogether the annual reports 2007 disclose more details
- PWC study criticizes - amongst others - the description of the valuation methods (Clariant ✓ Swatch ✓)
- Case Study and PWC Study show that disclosure is broadly in line with legal requirements
- **Future issues**
 - Details of severance payments (outside of change of control) should be clearly disclosed in year of agreement, plus disclosure of the total amount paid in relevant payment year ⇒ cf. Clariant
 - Clear description (calculation) of equity based compensation
 - Comprehensive information regarding the terms and conditions of the participation rights (option terms, exercise price, vesting)

Panel Meeting: Compensation Disclosure

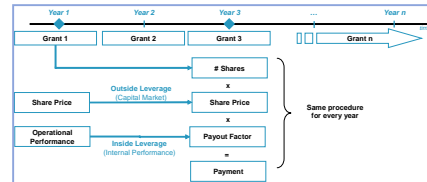
Dr. Stephan Hostettler,
Managing Partner



Compensation Design Aspects

Overview

Financial crisis



Sustainable performance and long term incentive schemes

Compensation@risk
Malus principle

Dreifacher Malus

Bonus auf dem Sperrkonto parkieren

Wenn der Bonus zum Malus wird

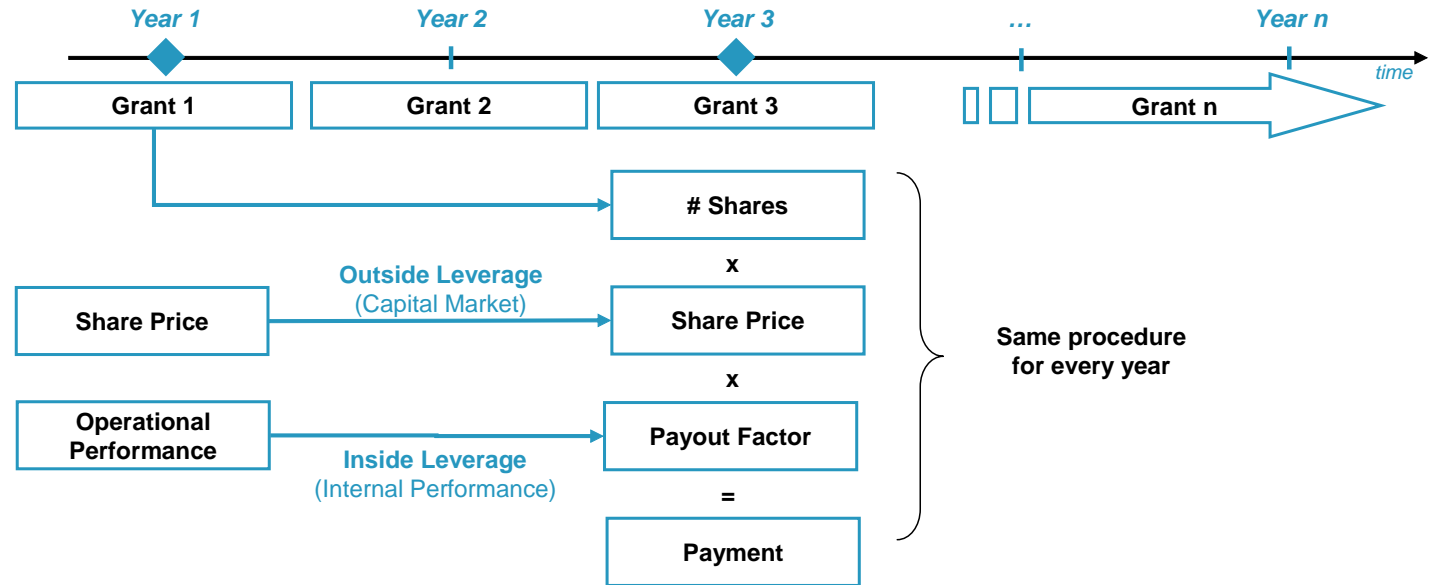
Disclosure of bonus plan details

to reduce the effect of short-term market fluctuations, security prices are averaged over the three months (October to December) prior to the start of a performance cycle and over the three months (October to December) at the end of the cycle. If Roche securities perform as well as or better than those of 75% of the peer set and, in addition, Roche's TSR increases at least 10% during a cycle, the Board of Directors can elect to increase the maximum NES award by as much as two-fold. In the event that an investment in Roche securities underperforms the average return delivered by the peer companies, fewer or no NES will be awarded. In 2007 NES were reserved under the plan for members of the Corporate Executive Committee as shown in the table on page 52. The Board of Directors will decide on the actual level of NES or the targeted number of NES, as permitted under the terms of the plan (see table on page 52 for details). At the end of the PSP 2005–2007 cycle (based on a three-month moving average at constant exchange rates) Roche ranked #3, compared with its peer set²⁰ of companies operating in the same industry; Roche's market capitalisation rose from 113 billion to 171 billion Swiss francs in the period from 1 January 2005 to 31 December 2007, an increase of 58 billion Swiss francs or 51.3%. Dividends totalling 6.813 billion Swiss francs (2005: 1.725 billion Swiss francs; 2006: 2.156 billion Swiss francs; 2007: 2.932 billion Swiss francs) were distributed during this period.

Compensation Design Aspects

Performance Unit Plan: Design Example

Example of a Performance Unit Plan



- Performance Units honors Capital Market-Performance (Outside Leverage) and Management Contribution to internal Performance (Inside Leverage)
- In some cases the Inside Leverage is driven by Peer comparison (TSR; Benchmarking)

Compensation Design Aspects

Performance Unit: Disclosure Example



Long-term Incentive (LTI)

The Long-term Incentive plan is a discretionary grant for a select group of key executives at Managing Director, Executive Board and Executive Committee level, over and above their annual cash remuneration. The intention is to achieve competitive total compensation for top executive talents by offering the participant a long-term incentive opportunity.

The LTI is based on a three-year rolling financial plan approved by the Board, and focuses on the achievement of three-year goals for return on equity and growth in earnings per share. A performance scale around a pre-defined target for both measures determines the level of reward earned at the end of each three-year performance cycle.

The LTI is offered each year and is denominated in units that are calculated as the grant amount divided by the share price at the grant date. The final payout will be the number of units multiplied by the share price at the end of the three-year period, as well as by a factor that can vary between 0% and 200% based on a matrix of average return on equity and compound earnings per share growth over the three-year period.

Long term incentive

Performance period

Target Setting

Multiplier

Source: Annual Report 2007, p112

		ROE (Average over 3 years)				
		8%	9%	10%	11%	...
EPS-Growth (CAGR over 3 years)	4%	0.6x	0.8x	1.1x	1.2x	1.4x
	5%	0.7x	0.8x	1.1x	1.3x	1.5x
	6%	0.7x	0.9x	1.2x	1.3x	1.5x
	7%	0.8x	1.0x	1.2x	1.4x	1.5x
	8%	0.8x	1.0x	1.2x	1.5x	1.5x
	9%	0.8x	1.1x	1.3x	1.5x	1.6x
	10%	0.8x	1.2x	1.4x	1.5x	1.6x
	11%	0.9x	1.2x	1.4x	1.5x	1.6x
	...	0.9x	1.2x	1.5x	1.5x	1.6x

Illustrative Example for EPS-Growth & RoE Matrix

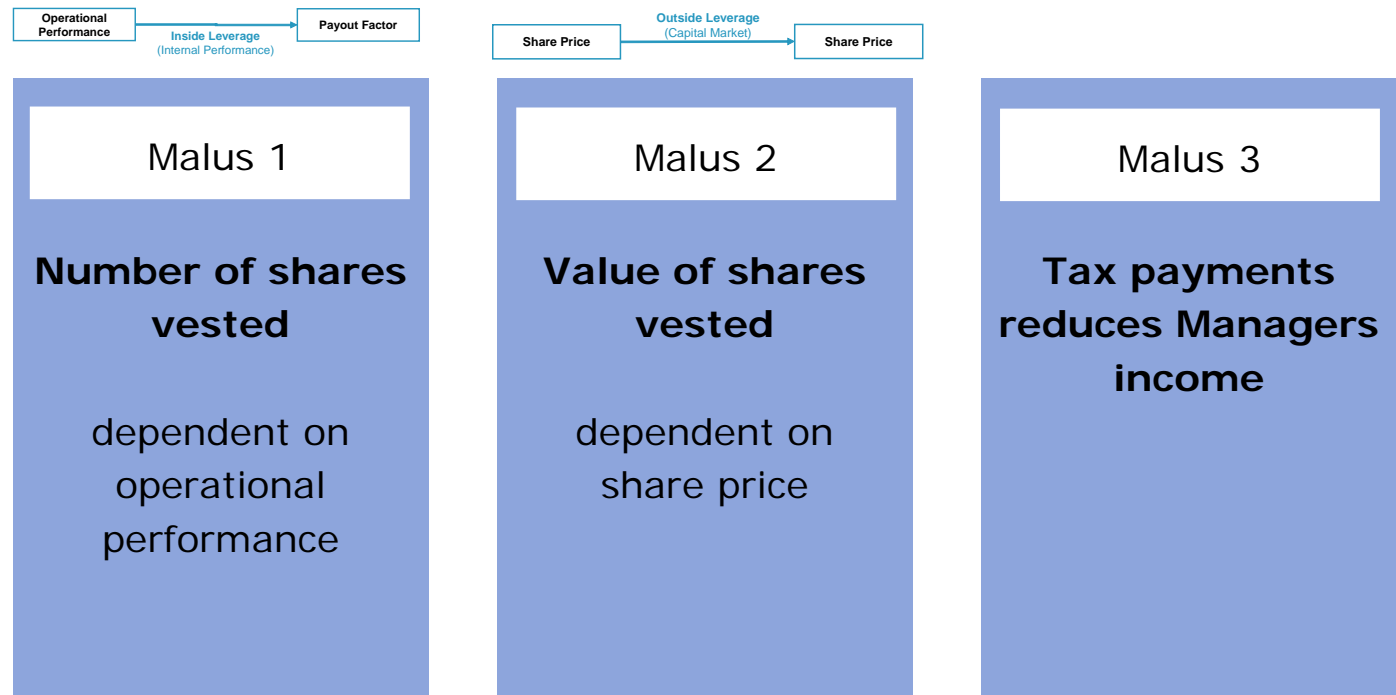
Compensation Design Aspects

Malus Principle



Weltwoche Nr. 45, 2008, p29

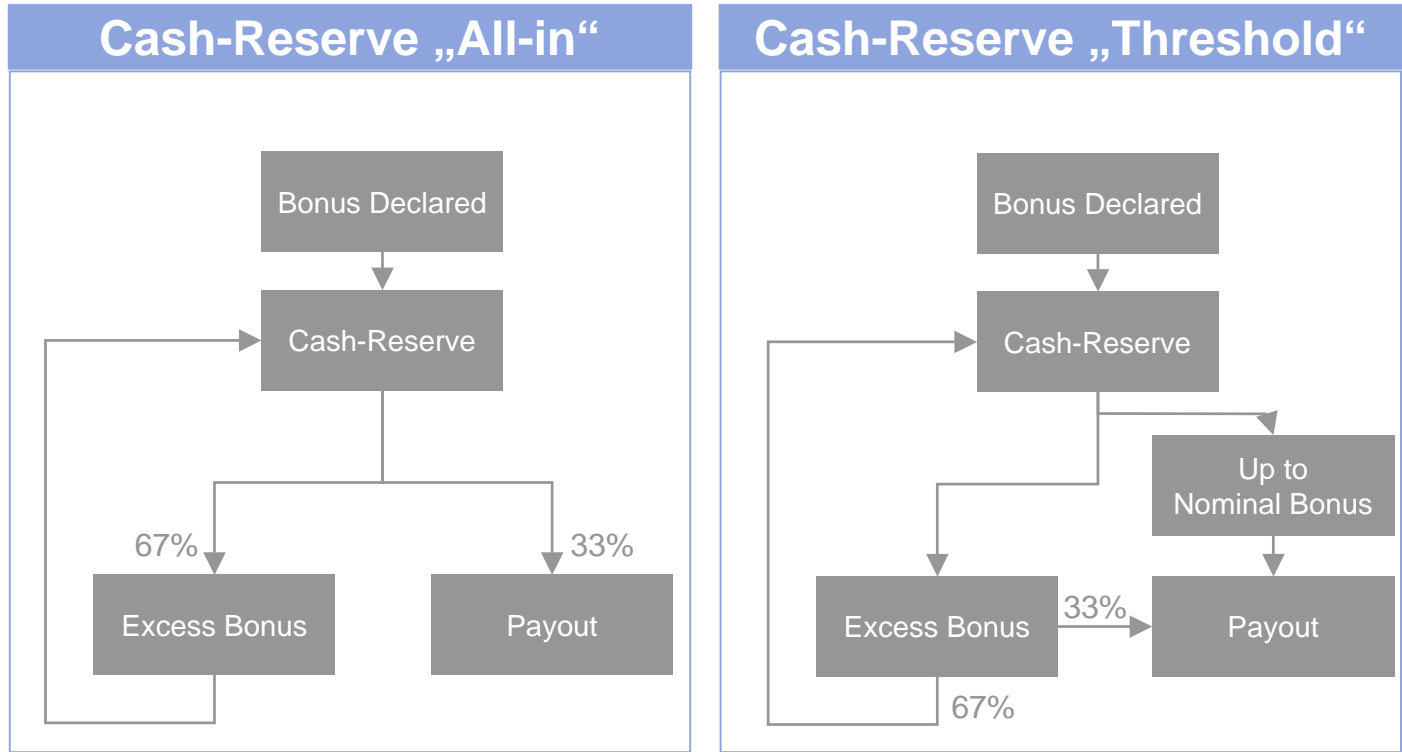
Löhne
Dreifacher Malus
 So müsste das Bonussystem der Zukunft aussehen.
Von Stephan Hostettler



Compensation Design Aspects

Malus Principle: Design Example Reserve

Design of a Cash Reserve



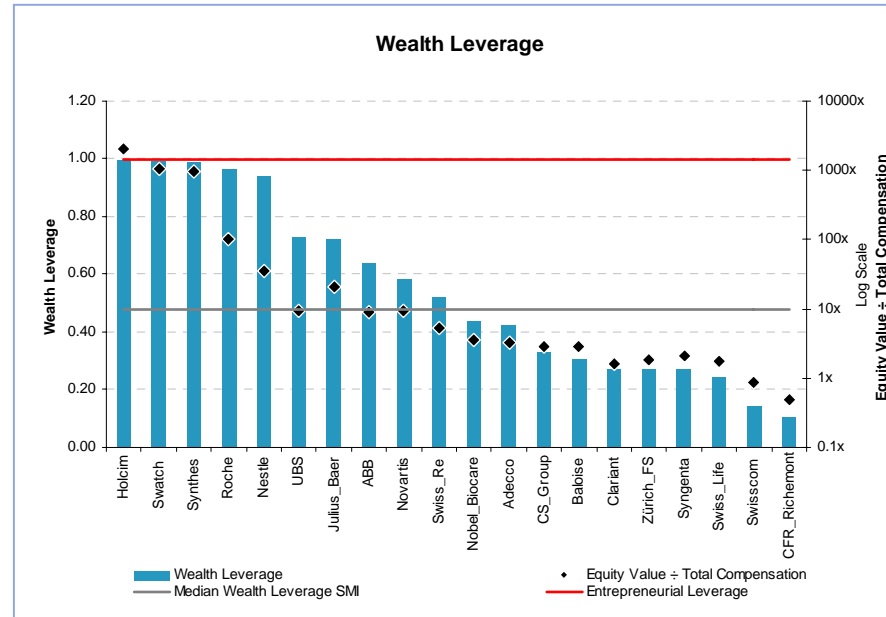
Advantages of a Cash-Reserve:

- Lengthens decision horizon for managers and further aligns managers' with investors' interests.
- Smooths bonus through fluctuating business performance, and, hence, helps to retain productive employees throughout business cycle ("insurance for managers").
- Holds managers accountable for delivering sustained long-term improvements in value contribution ("insurance" for investors).

Compensation Design Aspects

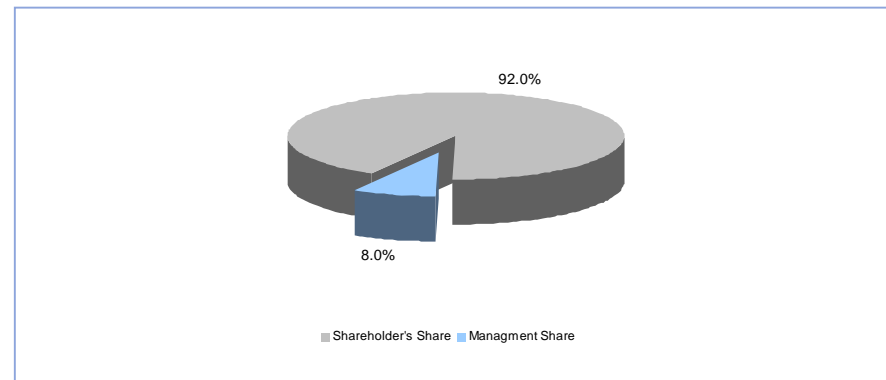
Comply with Shareholder Requirements

➤ Don't just comply with regulations, comply with shareholder's requirements



Wealth Leverage

➤ Measures the strength of a manager's incentive to increase shareholder wealth



Value Share

➤ Share of Value between Shareholders and Management

Contacts



Dr. Stephan Hostettler

Dufourstrasse 40
CH-8008 Zürich
Tel. +41 (0)44 560 33 33
Fax +41 (0)44 560 33 34
stephan.hostettler@hostettler.org
www.hostettler.org



Rodolfo Straub

Selnaustrasse 30
Postfach
CH-8021 Zürich
Tel. +41 (0)58 854 29 10
Fax +41 (0)58 854 26 32
rodolfo.straub@six-group.com
www.six-swiss-exchange.com



Prof. Dr. Rolf Watter, LL.M.

Brandschenkestrasse 90
CH-8027 Zürich
Tel. +41 (0)58 261 50 00
Fax +41 (0)58 261 50 01
r.watter@baerkarrer.ch
www.baerkarrer.ch