Paying executives fairly, what does the market tell us?

Our recent survey of the SMI companies paints a picture of the changing landscape of executive remuneration.

Executive pay remains hot on the agenda of Swiss companies, who grapple with maintaining sensible remuneration arrangements that match pay and performance with the demands of stakeholders. We will be separately updating you on the implications arising from stakeholder influence, in particular the say-on-pay agenda or what has been dubbed as the ‘shareholder spring’.

In this Performance & Reward update we provide insight to help companies who are focused on the primary question – getting executive pay right for their company. The starting point for this process usually requires current data on what comparative companies are doing so the issue of fairness and reasonableness can be addressed.

Benchmarks should be carried out in a way that will be relevant to each company. However, the SMI companies give us some insight into what leading companies are doing:
Average total executive board pay (including the CEO) increased only marginally by 8% in 2011 (11% for CEOs)

The compensation mix between the 3 compensation elements – base pay, bonus/short-term incentives (STI) and long-term incentives (LTI) – remains focused on variable compensation, however base pay increased substantially in 2011

Figure 1:
Snapshot Total Executive Board Compensation Levels for SMI Companies in 2011

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</thead>
<tbody>
<tr>
<td>Total direct compensation</td>
<td>64,690</td>
<td>63,699</td>
<td>38,639</td>
<td>28,798</td>
<td>19,182</td>
<td>11,617</td>
<td>8,403</td>
</tr>
</tbody>
</table>

Source: Audited SMI Annual Reports 2011 (excluding Synthes as no annual report was disclosed)

Figure 2:
Structure of Total Direct Compensation in SMI Companies

<table>
<thead>
<tr>
<th>Total Executive Board</th>
<th>CEO</th>
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<tbody>
<tr>
<td>2011</td>
<td></td>
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<tr>
<td>48%</td>
<td>53%</td>
</tr>
<tr>
<td>32%</td>
<td>27%</td>
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<tr>
<td>20%</td>
<td>20%</td>
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</table>

| 2012                  |     |
| 56%                   | 56% |
| 25%                   | 25% |
| 19%                   | 19% |

Source: Audited SMI Annual Reports 2011 (excluding Synthes as no annual report was disclosed)
Even though stock option plans remain common in SMI companies, the trend is towards instruments like performance shares or restricted stock units.

The most common LTI key performance indicators (KPI) is total shareholder return or TSR, and increasingly TSR will be measured relative to comparative companies.

Otherwise, both STIs and LTIs tend to be based on earnings and individual (financial and/or non-financial) KPIs. These kinds of insights help companies, regardless of their size, start internal discussions about whether remuneration arrangements remain appropriate. Our experience working with many of these leading companies confirms the above findings and has given us insight into the trends and issues companies will seek to address in near future and beyond.

Our Performance and Reward team is assisting companies addressing these challenges, including by preparing appropriate benchmarks, assisting throughout the review and redesign phase, rolling-out new incentive programs (taking into account legal and taxation implications) and helping companies meet increasing demands of disclosure.

**How Ernst & Young can help:**

- Companies are reviewing current practices and we can help by preparing appropriate benchmarks and modifying or introducing new remuneration arrangements.
- Total compensation is important, but so is net take home pay - in this regard, we can help advise on taxation implications during (not after) the remuneration design process.
- Reviews of remuneration will be conducted against looming expectations for increased shareholder say-on-pay, and we can assist with scenario planning and help companies benefit from increased transparency.

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