KPMG

Institut für Accounting, Controlling und Auditing

Universität St.Gallen

# Management Compensation in Swiss Business Practices

A status report for industry, trade and services

KPMG SWITZERLAND



AUDIT ▪ TAX ▪ ADVISORY

A study by KPMG Switzerland in co-operation with the Institute for Accounting, Controlling and Auditing at the University of St. Gallen

Contributors to this study:

Institute for Accounting, Controlling and Auditing at the University of St. Gallen
- Prof. Dr. Peter Leibfried, MBA, CPA, Director
- Lic.oec HSG Björn Petersen, Doctoral Candidate

KPMG
- Dr. Hubert Achermann, CEO
- Therese Amstutz, Attorney-at-law, Legal
- Reto Benz, Cert. Auditor, Audit
- Günter Haag, Cert. Auditor, Head of Audit
- Daniel Haas, Cert. Auditor, IFRS Advisory Services
- Sandra Heimüller, Marketing Manager
- Jürg Meisterhans, Cert. Auditor, Head of National Market Audit
- Michael Sterchi, Cert. Tax Expert, Head of Equity Compensation
- Ronald Schnurrenberger, Cert. Auditor, Audit

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# 1. Foreword

Debates rage in Switzerland about the compensation packages for senior managers. Opinions are tossed about from all sides to try to attract the attention of the public on this very sensitive issue, often putting Board members and executive managers in the hot seat. The question of the «right» compensation is an important topic for the auditors and consultants at KPMG. The discussion about the absolute level of individual remuneration for managers tends to overshadow other more important factors, such as the mechanisms and incentives of the compensation, the form of corporate governance and business ethics.

Facts are required rather than shrill opinions – superficial arguments are useless. Defining appropriate management compensation is one of the most important and difficult tasks of good corporate management and demands, apart from taking the competition into account, the responsibility of everyone involved. Not only does the actual compensation level have to be established but the individual components and the exact timing have to be decided and the evaluation process defined. Of particular interest at this stage, is the behavior and role of the key players involved. In addition, taxation, employment and corporate legislation aspects as well as accounting, reporting and disclosure have to be considered. Most of the time, in practice, it is not a question of sounding out extreme positions to justify a higher or lower compensation, but more about a quest to find an appropriate balance between various interests.

Within this context, the Institute for Accounting, Controlling and Auditing at the University of St. Gallen and KPMG Switzerland have carried out a survey of compensation practices in Swiss companies. This study does not provide any conclusive answers to the socio-political controversy regarding management wages but aims to contribute to an objective discussion and set more professional standards for the Board of Directors, through transparency. On the basis of an empirical study of common practice, orientation points and decision-making aids can be derived, covering typical compensation and processes in particular circumstances. A presentation of the most important taxation, employment and corporate law regulations as well as the demands made on accounting and reporting shall enable an initial assessment of how individual types of compensation should be handled.



Prof. Dr. Peter Leibfried
Director of the Institute for Accounting, Controlling and Auditing at the University of St. Gallen



Dr. Hubert Achermann
Senior Partner, CEO
KPMG Schweiz



Jürg Meisterhans
Member of the Board
KPMG Schweiz

# 2. The fifteen most important findings of this study

1. Boards and Executive Management teams are comprised on average of six people each. The members of the Board meet every two months, amounting to approximately 10 hours of their time, including preparation. (page 13–15)
2. Only about 60% of Board members are independent. In every seventh company, the CEO and the chairperson are one and the same. (page 16–17)
3. Maintaining a stable employee pool and a low turnover rate is the focus of the compensation policy. (page 18)
4. The international «Market for Managers» is only of minor significance. The level of compensation is usually orientated to companies of comparable size and from a similar industry based in Switzerland. (page 19–20)
5. The Board chairperson and the CEO are often present when their own compensation is being discussed. (page 21)
6. In most cases, there is little discussion at Board level about compensation; it is usually resolved without much debate. (page 22)
7. Compensation to the members of the Board is usually recommended by the chairperson. The remuneration of executive managers is normally proposed by the CEO. (page 23)
8. The members of the Board are usually compensated with fixed amounts; there are hardly any performance incentives. The situation is different for executive managers where about one third of the compensation is variable. (page 24–26)
9. In practice, variable compensation is almost exclusively paid out in cash. Shares and options play only a secondary role. (page 26)
10. Compensation is usually defined for a short period of one year; agreements for longer periods are rare. (page 28)
11. Profit, yield and sales parameters are central in measuring variable compensation. The basis is usually the budget for the next year. (page 28)
12. «Golden parachute» agreements are of little significance in practice. (page 35)
13. A few exceptional cases appear to fuel the public debate on the absolute level of compensation. The large majority of executive managers and Board members do not have gratuitous compensation packages. (page 36–38)
14. In the opinion of the companies, compensation for Board members will tend to increase, whereas the compensation paid to executive managers will remain unchanged. (page 54)
15. Company management does not want the annual shareholders' meeting to make any decisions on compensation. (page 54)

# 3. Management Summary

Defining appropriate compensation for management while considering many different requirements is a core element of good corporate governance. In the recent past, the subject has given rise to public debate in Switzerland, with Board members and executive managers often put in the spotlight.

In this context, this study aims to provide transparency on current practice and establish orientation points and decision-making aids about which processes and remunerations are expected under which circumstances. In addition, the most important taxation, employment and corporate legislative regulations are presented.

*Companies surveyed*

Questionnaires were sent to the CEOs of the 500 largest companies in Switzerland (without banks and insurers). The feedback ratio was about 18%, whereby the standardized questionnaire was mostly filled out by the CEO, CFO or Board Chairperson. 38% of the participants in the survey are listed on the stock exchange. Overall, the participating companies make up an appropriate cross-section.

*Structure and working process of the decision-making bodies*

The size of the Board of Directors depends on the size of the company and averages 6.5 people. The Executive Management Board, with an average of 5.8 people, is somewhat smaller. There are seldom fewer than four and rarely more than eight members.

The Board of Directors meets on average every two months, requiring 10 hours of commitment per person including preparation time. Committee work has hardly been developed to date; only 60% of the companies have created any committees at all. 38% of the surveyed companies have a Compensation Committee.

*Independence of Board members*

About half the participating companies are controlled by a single shareholder or family. In more than two thirds of all cases, they also act as Board Chairperson or deputy. In almost all other cases, at least one member of the Board is associated with the shareholder's group. As far as the level of compensation is concerned, statistically significant effects cannot be identified due to this management structure.

On average, about 60% of Board members are independent. The range is very broad however, varying from «none» to «all.» In most cases, the absence of independent counsel is attributed to current or earlier engagement with the company.

In approximately every seventh company surveyed, the CEO and the Board Chair are one and the same. The majority of companies in this case are controlled by a single shareholder or family. Note-worthy is that the opposite does not apply – in only 15% of family-controlled companies does the same duality exist. Apparently, individual or family shareholders appreciate the benefits of a balanced relationship between management and control.

*Factors of influence on compensation*

Maintaining a stable employee pool with a low turnover rate is a core factor in compensation policy. Attracting new candidates is of lesser importance.

The level of compensation is orientated to companies of comparable size and in a similar industry in Switzerland. The frequently cited international comparison on the «Market for Managers» is apparently of little significance for the companies surveyed. The size of the company plays a role in calculating the compensation, however the profit position is usually of no importance.

The Board chairperson and the Compensation Committee have the greatest influence in defining compensation to the Board members. Compensation for the executive managers is influenced primarily by the CEO and the Compensation Committee.

*Resolution compensation*

To date, compensation guidelines have only been established in little more than half of the companies. Compensation committees are not yet common but – to the extent that they exist – are largely independent. The Board chairperson and the CEO are, however, very often present when their own compensation is being discussed – a clear infringement of corporate governance.

The specific proposal for compensation to be paid to members of the Board is usually made by the chairperson. The CEO usually suggests the compensation for Executive Management members. In general, the Board does not devote much time to discussing compensation; it is largely resolved without extensive debate.

Compensation advisors are of secondary importance; only one out of every fifth company seeks their involvement. Most of the time, their contribution is restricted to the creation of an overview of prevailing market conditions.

Compensation is usually defined for a very short period of one year. Agreements for longer periods are relatively rare.

*Fixed and variable compensation*

For the Board of Directors and from a value point of view, there are practically no performance incentives in the compensation; it is usually fixed. Variable components for Board members are only foreseen in every fourth company. It was also not possible to identify a statistically significant connection between the time spent for a Board mandate and the absolute level of the compensation granted. Noteworthy, however, is that Board members with a higher proportion of variable compensation require significantly more time for the task than those paid a fixed rate. The incentive effect which is often attributed to variable compensation therefore does seem to exist.

In approximately three quarters of the cases, the Board chairperson and his or her deputy received a higher compensation than the other members of the Board. Professional experience and particular expertise play almost no role in determining compensation.

In contrast to the Board, variable components are major factors for Executive Management. About one third of the compensation is granted in variable form. Because shares are tradable, listed companies add shares and options to the compensation much more often, and the variable compensation for the CEO is significantly higher than in the case of unlisted companies.

*Components of compensation*

Seen as a whole, the variable compensation for executive managers is comprised almost exclusively of cash payments. Shares and options are hardly of any significance in terms of value. Nevertheless, the established programmes can be positively assessed in terms of their incentive effect. The exercise price of options is almost always equal to the fair market price at the time they are granted, which helps to avoid any «free lunches».

The share of total remuneration represented by fringe benefits is very low. A company car is a common perk for managers, and subsidized loans are also occasionally granted. In some cases, pension arrangements are granted which exceed the legal minimum and any second tier pension. Other fringe benefits are of practically no significance.

For Board members, fringe benefits have almost no significance at all.

*Measurement of variable compensation*

Profit, yield and sales parameters are at the forefront of measuring variable compensation. The incentive factor is mostly directed at remaining within the budget for the following year. Medium and long-term objectives are of secondary importance, giving rise to serious concerns in terms of long-term company development.

The incentive effect of granting bonuses is frequently unfocused. There is often discretionary leeway in the allocation, and in about three quarters of all cases the bonus is upwardly limited. Minimum bonuses can be found in every fifth case.

*Severance pay on termination*

Public perception of the significance of this topic has been affected by a few prominent, individual cases. But in practice, agreements on «golden parachutes» only exist in isolated cases. For Board members, conditions of that kind hardly exist at all, and for executive managers, they are foreseen in only one case out of five. Severance pay usually amounts to the equavalent of between one to two years salary.

*Level of compensation*

Here again, a few exceptional cases have fueled public debate. However, the large majority of executive managers and Board members do not receive excessive compensation packages.

- CEOs generally receive between 200K–600K (CHF),
- other members of Executive Management usually receive between 200K–400K (CHF).
- A Board Chairperson usually receives between 100K–300K (CHF),
- other members of the Board receive between 25K–60K (CHF) in most cases.

These figures encompass all the components of compensation.

Basically, larger companies pay higher salaries than smaller organizations. Based on the feedback, it can also be assumed that the presence of a Compensation Committee tends to lead to lower compensation. Statistically significant is the evidence that in companies in which the Board chairperson and the CEO are one and the same person, the compensation for those functions is higher than in companies with separate representatives. At the same time, the proportion of variable compensation is higher when the chairperson and the CEO are the same person.

*Accounting and reporting*

Modern accounting and reporting standards such as the Swiss GAAP or the International Financial Reporting Standard (IFRS) have, in the meantime, become widespread even among companies that are not listed on the stock exchange. More than three quarters of the companies that were surveyed prepare their consolidated financial statements in accordance with one of the two standards.

It is largely a matter of course that all cash-effective expenses for personnel must be recorded in the profit and loss account. As far as capitalization and valuation is concerned, the cost-effective recognition of share-based compensation (non-cash) must also be specifically noted. According to the Swiss Code of Obligations (SCO) and the Swiss Accounting and Reporting Recommendations (ARR or FER in German), that was normally not the case in the past. Currently, there are signs of a change so that cost-effective recognition also takes place under the SCO. IFRS and ARR also include significantly more comprehensive regulations regarding recording and disclosing pension benefits in consolidated financial statements.

At the moment, the rules of disclosure determined by ARR and the SCO are minimal to non-existent, IFRS however, has stricter requirements. Significant additional requirements for listed companies are derived from the Corporate Governance guideline of the SWX, in effect since 2002. Furthermore, the change in the corporation law, which goes into effect in 2007, will also play a role, but only for listed companies. Whereas in the past only the total of all compensations as well

as the highest individual board member net worth had to be disclosed, individual details for all the Board members and CEOs will now be required.[1]

*Taxation*

Cash compensation and fringe benefits have to be declared in the annual salary statement and are subject to income tax and social security for the recipient. For the company, they represent tax-deductible personnel costs.

Not yet standardized at the moment is employee profit-sharing. The granting of shares is generally subject to tax payable by the recipient and based on the fair market value of the shares, whereby a discount is granted for any vesting periods that might exist. The handling of options currently differs from canton to canton and is intended to be standardized by means of new legislation. From the point of view of the company, profit-sharing only represents tax-deductible costs if the relevant expenses have also been recorded in the individual financial statements based on the SCO and/or ARR.

*Employment and corporate legislative framework conditions*

From the point of view of corporate legislation, the obligation of Board member loyalty and capital protection stipulations must be particularly observed. Excessive compensation – which is clearly not equal to performance, does not conform with usual market conditions and is not in the interests of the company – can violate the loyalty obligation under corporation law and give rise to liability for the Board. In addition, in the case of compensation to Board members, the company can claim reimbursement. If the company is not already in possession of the shares which it grants in the form of share-based compensation, it must either increase its capital or buy back its own shares. For a capital increase in the case of options, conditional capital is particularly useful. When the company buys back its own shares, possible upper limits and demands made of the available reserves (usually 10% of the entire capital) must be taken into consideration.

From an employee legislative point of view, qualification of the compensation as salary or gratuity is of major importance. A salary is subject to all the protective stipulations embodied in employment legislation, which is not the case for bonuses. Refusal to pay a prorated bonus if the employment arrangements are terminated in the course of a year can violate the ban on salary retention or salary reduction for work already performed, if the bonus is qualified as salary. Differentiation criteria between salary and gratuity are, apart from the what is described in the employment contract, the determination of the level (tendency to salary if measurement based on the achievement of pre-defined targets, and tendency to gratuity if measurement is at the free discretion of the employer), the size relationship between additional components and the base salary and the frequency of payment (which tends to be the salary if the proportion of additional components is high or frequent payments are made).

[1] The relevant stipulation demands disclosure of the entire amount for executive management and the highest individual amount giving the name and the function of the relevant member. He or she is likely to be the CEO in most cases.

*Outlook*

Management compensation will remain a topic of ongoing discussion. Increasing demands made on executive managers and Board members, the growing risk of negative influence on their reputation and assets as well as increasing globalization and dynamic sampling will also sustainably influence the «Market for Managers» in Switzerland.

The respondents to the survey expect the following trends:

- The most important form of compensation will continue to be cash. The significance of shares and options has suffered badly from developments on the capital market in recent years. Options, in particular, will continue to lose importance.
- Compensation for Board members will tend to increase, whereas that paid to executive managers will remain unchanged.
- Incentive-based compensation will not increase any further that it has already.
- The annual Shareholders' meeting should refrain from involving itself in defining compensation.

In the disclosure obligations, a middle ground is desired. The majority of respondents rejected the suggestion of disclosing individual compensations, as proposed by the corporate stock law revisions aimed at providing more transparent oversight of compensation practices for Board members and the executive team. They are, however, generally prepared to disclose the total amount of all compensations.

From a corporate governance framework, only general compensation stipulations are expected. The companies surveyed did not want specific guidelines for the amount or the manner of termination renumerance.

# 4. Details of the Survey

### 4.1. Methodology and feedback

We questioned the CEOs of the 500 companies in Switzerland with the largest sales figures.[2] The banking and insurance industries were excluded because of the other framework conditions in place for the Executive Management and Boards of directors.

The survey was conducted with a standardized, thirteen page anonymous questionnaire. The survey was carried out in May and June 2006, and evaluated in July 2006.[3]

The feedback ratio was 18%, a good ratio, in view of the particular sensitivity of the subject, the impossibility of targeted clarification due to anonymity and the necessity of personal co-operation at the most senior management levels.

Responses to the questionnaire were given in two thirds of all cases by the CEO, CFO or the Board chair personally.

### 4.2. Companies surveyed

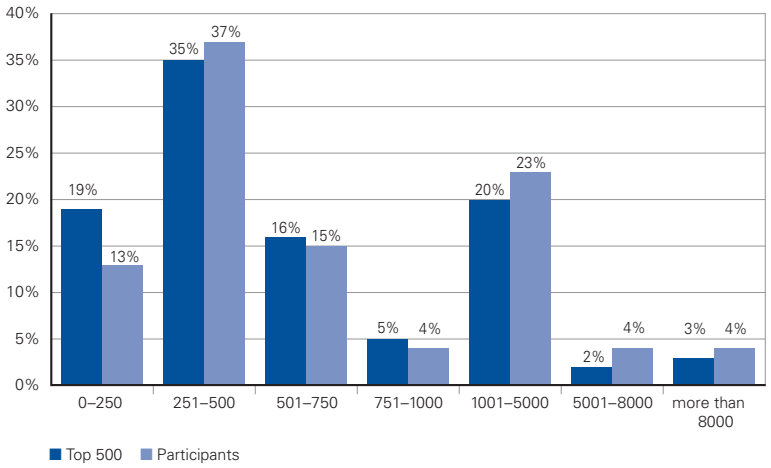
*The survey results are representative*

Included in the evaluation were companies from nine different industries. The industrial goods, technology, motor vehicles and trading sectors were represented frequently with about 22% each. Followed by 5% to 9% representation for chemicals/plastics, services, transport/logistics/public transport as well as energy production and distribution.

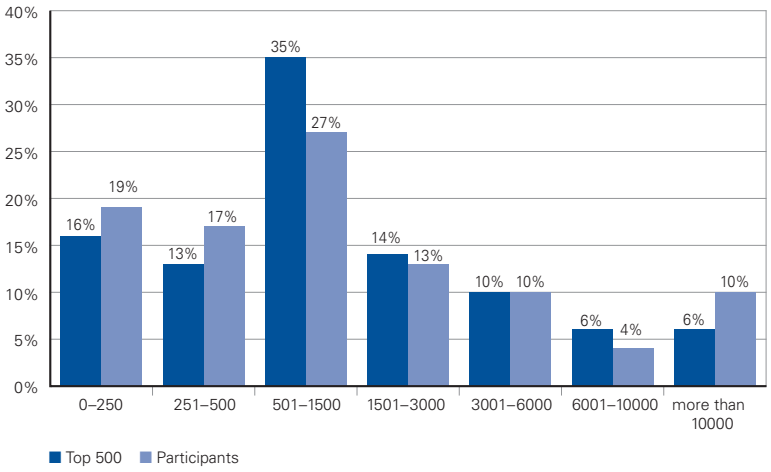
In terms of important structural data such as sales and numbers of employees, the feedback is largely representative of the entire group of companies approached. However, smaller companies are slightly under-represented.

[2] According to the *Handelszeitung* list (Top 500 does not including banks and insurance companies).
[3] Tests were carried out to measure connections (a connection is regarded as significant if the probability of error is lower than 10%).

## Comparison of sales from participating companies with the Top 500 (in million CHF)




## Comparison of the number of employees of participating companies and the Top 500



*The focus of the study is on Swiss companies and Swiss circumstances*

Of the participating companies, 62% are privately held and 38% are listed on the stock exchange. The majority of stock exchange listings are those of the parent company (77%); pure subsidiaries are of secondary significance in the survey. 90% of the companies therefore stated that they can basically define their compensation structure themselves.

About two thirds of the stock exchange listings are exclusively in Switzerland. One third are listed additionally or exclusively abroad. Four companies are subject to the Sarbanes-Oxley Act.

*Modern accounting and reporting standards are now widely applied*

The participating companies are open to improvements in the financial field. Only 13% still prepare their consolidated financial statements exclusively in accordance with the SCO. 30% apply the Swiss GAAP ARR and 53% apply IFRS. Only 8% report under US-GAAP (multiple designations are possible).

Since only 38% of the participants are stock exchange listed and therefore obliged to apply capital market orientated accounting and reporting standards, it appears that the use of modern accounting and reporting standards has been done largely on a voluntary basis. It's clear that the benefits of transparent fair value oriented reporting often exceed the costs of converting to one of the modern standards, even if there is no specific obligation to change to ARR or IFRS. This corresponds to the discovery that only a little more than half of the IFRS users and very few ARR users are listed on the stock exchange.[4]

[4] Since the beginning of the fiscal year on January 1, 2005 or later, only IFRS and US-GAAP are recognized as accounting and reporting standards on the main Board of the SWX Swiss Exchange. Swiss GAAP ARR is only permissible in the segments of SWX local caps as well as real estate and investment companies.

# 5. Structure of the decision making bodies

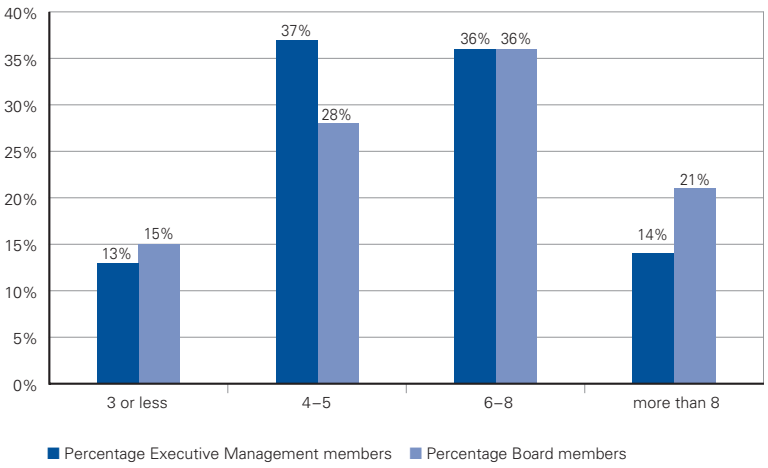
### 5.1. Size of the Board of Directors and Executive Management

The size of the Board of Directors or an Executive Management Board does not necessarily have anything to do with their quality. Small decision-making bodies often have the advantage that they can reach decisions more quickly and efficiently. However, the inclusion of a larger number of people has its advantages, by combines a larger wealth of experience and enabling better distribution of tasks as well as more in-depth handling of individual circumstances.

*Executive management has an average of 5.8 members, the Board of Directors averages 6.5 members*

The Board of Directors is usually a little larger than the Executive Management Board. The variety in both governing bodies is significant, but there are seldom fewer than four or more than eight members.

**Number of Executive Management and Board members**




*The size of the governing bodies depends on the size of the company*

In view of all the participating companies, a statistically significant connection can be determined between the size of the company and the number of members of the Executive Management Board and/or the Board of Directors.

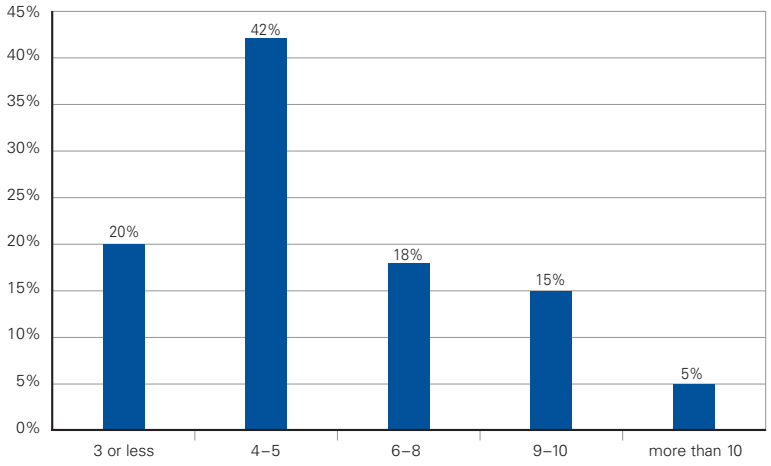
### 5.2. Working methods of the Board

Regular meetings are the central platform for the exchange of information and decision-making for the Board of Directors. Executive management reports on current developments and the Board has the opportunity to ask follow-up questions. On the basis of documents which are circulated in advance, decisions are made with regard to important strategic redirection and business principles.

*The working methods of a Board of Directors differs widely; on average, a meeting takes place every two months and requires about 10 hours of commitment, including prep time*

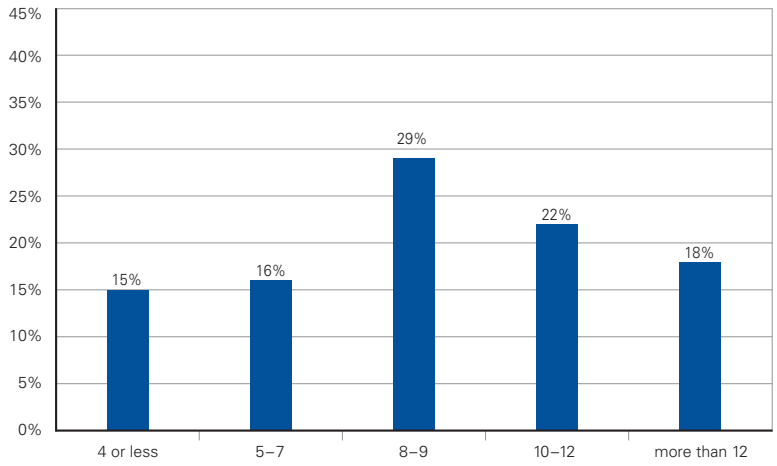
Within the course of a year, an average of 5.6 Board meetings took place at the companies surveyed. Most of the companies have 4–5 Board meetings per year. Ten and more meetings are rare. In about every fifth company, the Board meets three times a year at most.

### Number of Board meetings per year




The average time expended per meeting, including preparation time is approximately ten hours. There was a slight statistical connection between the size of the company and the time expended. Neither the type of industry nor a listing on the stock exchange had any significant influence on the time.

### Time expended per Board meeting in hours (including preparation time)



*The absolute level of compensation depends on the time expended by a Board mandate; however, the engagement in terms of time spent increases if variable compensation is granted*

It was not possible to find a statistically significant connection between the time expended for a Board mandate and the absolute level of compensation. However, in some cases the compensation is comprised of a fixed and a variable component. Noteworthy here was that Board members with a higher proportion of variable compensation spent significantly more time on tasks for the meeting than members who are paid on a fixed basis. Which seemingly confirms the incentive effect repeatedly attributed to variable compensation.

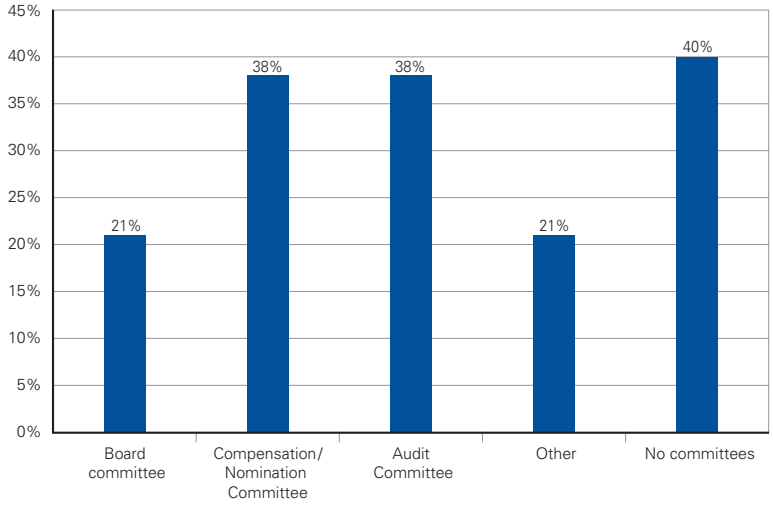
### 5.3. Board committees

The tasks which have to be carried out by the Board of Directors are diverse, and there is often little time available to reach decisions. An in-depth discussion of all the relevant issues is often not even possible. In practice, committees are formed which, taking the competences and experience of their members into account, handle certain specific tasks and deal with them in more detail.

*The work in committees has been under-developed to date*

Only 60% of the participating companies have, until now, established any type of committee at all, most commonly compensation and audit committees. A statistically significant connection was identified between listing on the stock exchange and the existence of committees, i.e. listed companies show a stronger tendency to build committees. Furthermore, the larger the Board of Directors the higher the likelihood for commitees.

**Board committees**



### 5.4. Control of companies

*Controlling sole shareholders and families play a major role*

About half of the participating companies are controlled by a sole shareholder or a family. In two thirds of the cases, these controlling instances determine the Chairperson or his/her deputy or, in almost all the other cases, at least a member of the Board. However, there is no impact on compensation.

Inclusion in Executive Management tends to be rare. In only 22% of the cases is the controlling party active as CEO or CFO. In most cases, the person simultaneously carries out the functions of Board Chairperson and CEO.

It was not possible to identify a statistically significant connection between the existence of control and the level of compensation. Shareholders who are simultaneously represented in Executive Management or the Board of Directors apparently do not fix the compensation at particularly low or particularly high levels, at least to the extent that they are not active as Board Chairperson and CEO at the same time.

### 5.5. Board member independence

The independence[5] of Board members is a core element in the internal management of companies. The Board of Directors monitors the implementation by Executive Management of the strategic direction and principles for which the Board is responsible. The balance of management and control at the top level serves for good overall management and repeatedly leads to public debate. A temporary deviation from this principle only seems to be regarded as acceptable in extenuating circumstances.

*Only in 15% of family-controlled companies the CEO and the Board Chairperson are one and the same*

In approximately every seventh company surveyed, the CEO and the Board Chairperson are one and the same. The majority of companies in this case are controlled by a single shareholder or family. Noteworthy is that the opposite does not apply: Only in 15% of family-controlled companies does the same duality exist. Apparently, individual or family shareholders appreciate the benefits of a balanced relationship between management and control.

*Dual function results in higher compensation*

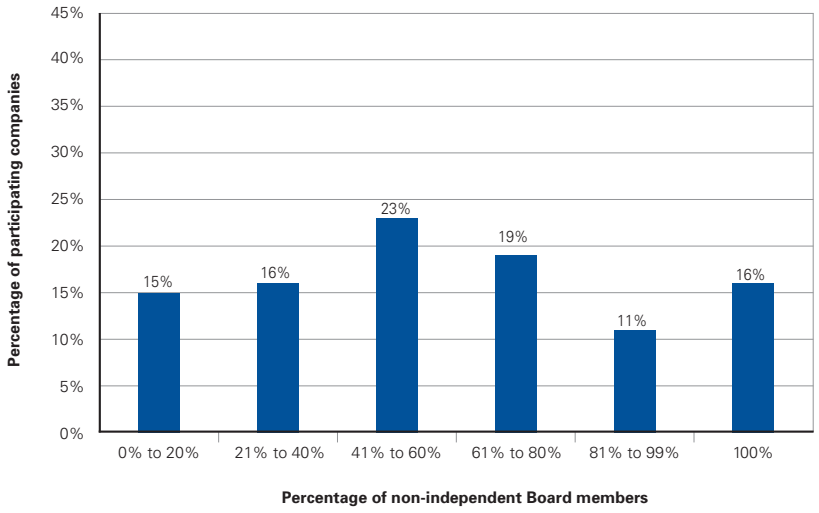
Based on the available data, the compensation packages of CEOs in companies with and without a separation of functions differ in a statistically significant manner. The compensation is higher if both functions are carried out by the same person – and the CEO, acting as the Board Chairperson, is thus involved in the definition of his or her own compensation. However, it should be noted that when both functions are carried out by the same person, the proportion of variable compensation is higher than in the case of separated functions.

[5] A member of the Board can be described as independent if he or she was not active in the company earlier, if there are no cross mandates (managing employee of Company A is a Board member for company B or a managing employee of Company B is simultaneously a Board member of Company A), and if there are no other close relationships to the managing members of the Board and Executive Management.

*The independence of Board members is frequently not known*

On average, 3.9 of the 6.5 members of the Board are independent. However, the range is very wide, from «none» to «all.» In about three quarters of the cases, the absence of independence is attributed to current or earlier engagement for the company.

**Proportion of non-independent Board members to total Board members[6]**




[6] For example, in 23% of responding companies, 41%–60% of the Board members are not independent.

# 6. Definition of compensation

### 6.1. Principles of the compensation policy

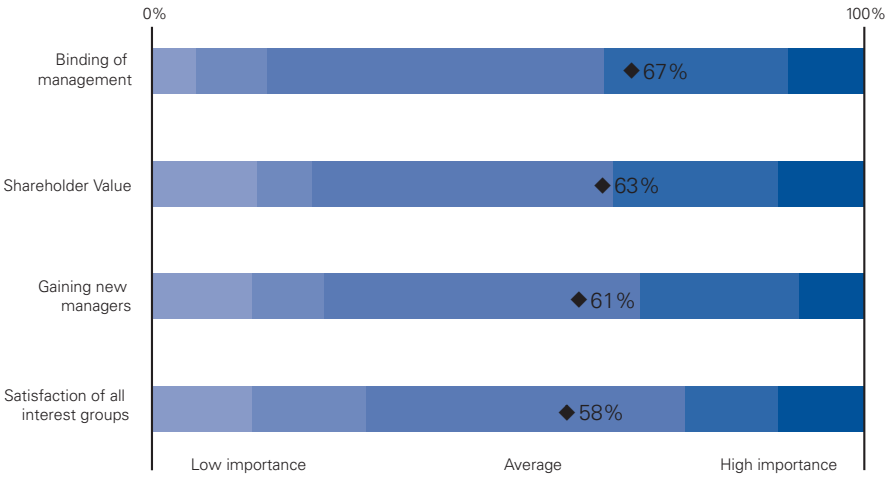
According to the Swiss Code of Best Practice for Corporate Governance[7] the following principles should be followed in compensation policy:

- The aim of the company's compensation policy should be to offer overall compensation which conforms to the market and performance in order to gain and retain persons with the necessary capabilities and characteristics.
- The compensation should be dependent upon the sustainable success of the company and the personal contribution; false incentives are to be avoided.

*Retention of a stable employee pool is central to the compensation policy*

When they define compensation, the companies questioned focus as a central target parameter on the long-term commitment of current employees. A short distance behind is the creation of incentives to maximize shareholder value and gain new candidates. Achieving a balance between the involved interest groups is of lowest priority.

**Objectives of compensation policy**




*Compensation guidelines have only asserted themselves to a limited extent*

Compensation guidelines can help maintain general, consensual principles even when they are used in a specific, individual case where conflicts of interest arise. On the other hand, the mere existence of guidelines provides no guarantee that their content corresponds to an appropriate compensation policy and that they are used correctly.

[7] Published by the umbrella business association *economiesuisse*.

Somewhat more than one half of the companies surveyed have compensation guidelines.

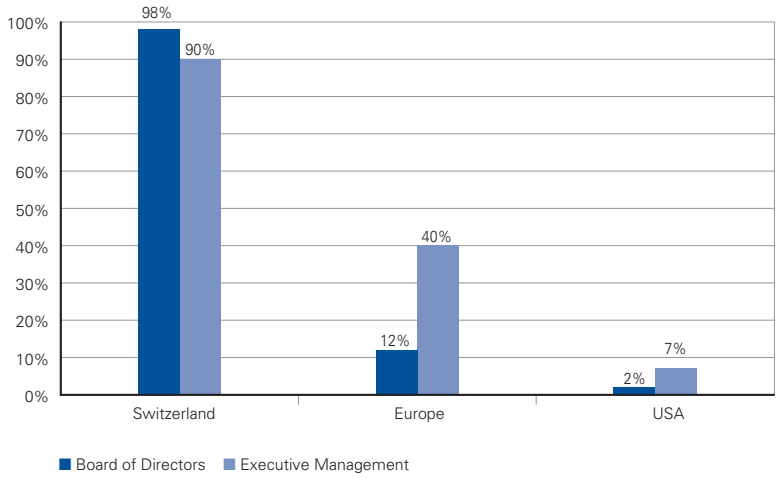
### 6.2. Factors of influence on compensation

The question as to why the compensation paid to senior management has a certain structure and amount is difficult to answer. One factor which must always be kept in mind is the market standard for compensation as compared to other employers. There is often disagreement about a suitable measure of comparison because in western countries, salaries tend to be significantly higher. The basis used for compensation often depends on which parties, within and outside the company, can influence the decision.

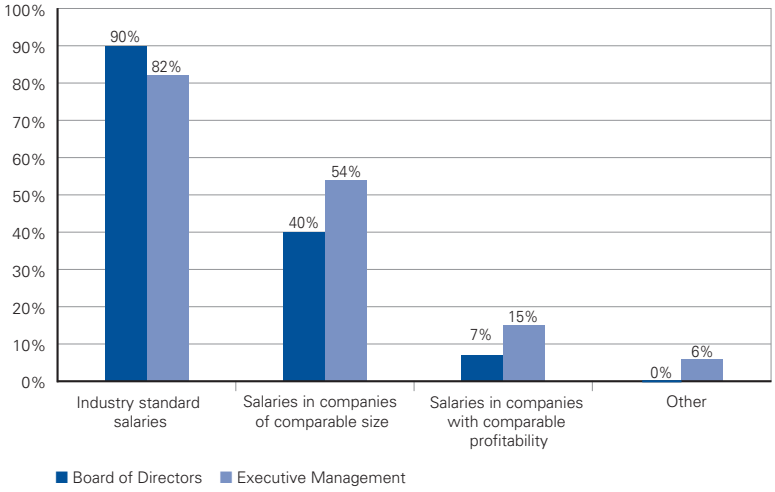
*The level of compensation is orientated to companies of a comparable size and from a similar industry in Switzerland (and partly in Europe)*

In the same way that a company has to assert itself against its competition, the compensation paid to senior management is also compared with what other companies in Switzerland (and partly in Europe) are offering. Comparison with the USA is, however, of little significance. The size of the company plays a partial role, while the profit situation is largely insignificant. As a consequence, the companies surveyed orientate themselves to the following benchmarks in their definition of compensation (multiple answers possible):

**Regional benchmarks in defining compensation**



**Other benchmarks in defining compensation**




*Board Chairs and Compensation Committees have the greatest influence in the definition of compensation for the Board of Directors*

From a structural point of view, the survey showed the following main points of influence in defining compensation:

- The compensation for Board members is influenced primarily by the Compensation Committee (if one exists), followed closely by the Board Chairperson and the full Board of Directors. The CEO, CFO, Human Resource departments and compensation advisors only play a subordinate role.
- Compensation for Executive Management is decided primarily by the Compensation Committee (if one exists), closely followed by the CEO and Board Chairperson. The overall Board of Directors, the CFO, the Human Resources department and compensation advisors factor far behind in a secondary role.

### 6.3. Compensation Committee tasks

According to the recommendations of the Swiss Code of Best Practice for Corporate Governance

- the Board of Directors should appoint a Compensation Committee which is responsible for regulating the compensation policy of the company as a whole and at top management levels in particular.
- The Compensation Committee should consist of mainly non-executive, independent members of the Board of Directors.
- The Board Chairperson or CEO can participate in the meetings as long as he or she does not deal with his or her own compensation.
- The principles worked out by the Compensation Committee are submitted to the full Board of Directors for approval.

Above and beyond the direct recommendations of the Swiss Code of Best Practices, further measures are appropriate to handle the definition of compensation in an orderly manner and in the interests of the company. No member of the Board should be able to define his/her compensation themselves. The processes in the Compensation Committee should be transparent and understandable for outside parties.

*Compensation committees are – to the extent that they exist – largely independent*

Only 38% of the companies surveyed currently have a Compensation Committee, with an average of 3.4 members meeting two to three meetings per year. The time expended, including preparation, is an average of 4.2 hours per meeting. In comparison with the Boards overall, the composition can be described as more balanced; only about one member out of five is not independent.

*The Board Chair and the CEO are very often present when their own compensation is being decided*

In about 90% of all cases, the Board Chair is also a member of the Compensation Committee. Contrary to the recommendations of the Swiss Code, he or she is almost always present when his or her own salary is being discussed.

Also in about 90% of the cases, the CEO participates in meetings of the Compensation Committee, albeit as a guest. Particularly when the Board Chair and the CEO are one and the same person, he/she tends to be a member of the Compensation Committee. In somewhat less that half of the companies surveyed, the CEO is present when his/her own salary is being discussed; this should be regarded as a very high percentage.

*Compensation Committees can lead to lower compensation*

According to the survey, a connection was identified between relative compensation volume (level of compensation in relation to company sales) and the existence of a Compensation Committee. The compensation paid by those companies that had a committee of this kind was lower. The figures were not significant in terms of the statistical level which formed the basis of this study, but they were nevertheless noticeable. It is plausible that the discussions which take place in a Compensation Committee lead to a generally restrained compensation policy.

### 6.4. Involvement of compensation advisors

The work of the Compensation Committee can be supported by compensation advisors. Their field of activity differs from that of human resource advisors in that they are not primarily active in the search for suitable candidates but provide services in connection with the structure and level of compensation. If they are mandated, compensation advisors should also be independent from the company's management. This can be assured if the Compensation Committee gives the mandate itself, for which an appropriate budget should be foreseen. Furthermore, the advisor should not be active anywhere else within the company.

*In practice, compensation advisors are only of relatively minor significance*

Only about one in five of the companies surveyed work with compensation advisors. Their main activity is to provide an overview of the compensations that are normal in the market. Advisory activities with regard to the structuring or level of compensation are rare.

### 6.5. Compensation resolution

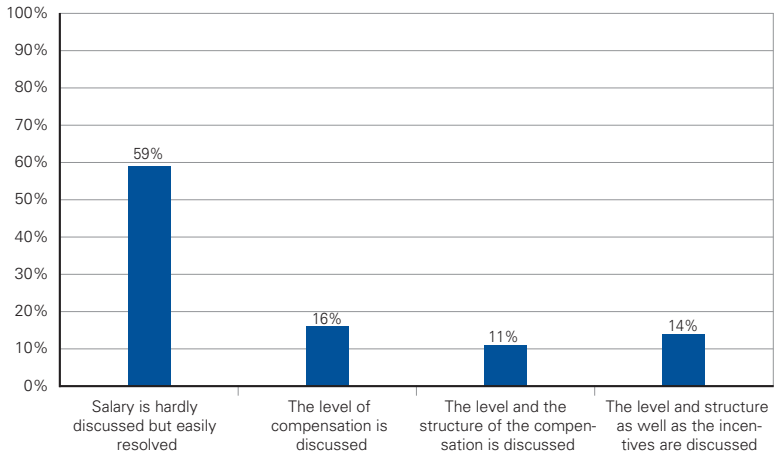
In most cases, the involved parties do not find it easy to discuss compensation, particularly if the recipient of the compensation is present. They will usually be interested in compensation that is as high as possible without wanting to appear too aggressive. On the other hand, those granting the compensation do not want to pay too much, but they also do not wish to play down good performance or lose a good candidate by being stingy.

A compensation structure that has been approved has to be regularly reviewed and adapted as necessary. In this process, a downward adjustment should result.

*There is little discussion of compensation by the Board of Directors*

In somewhat more than half of the companies surveyed, compensation for senior management is not discussed at the level of the Board of Directors as a whole but, to a large extent, resolved without debate. The compensation is presumably fixed before the Board meets, however, it is worth noting that only 38% of the surveyed companies currently have a Compensation Committee in place.

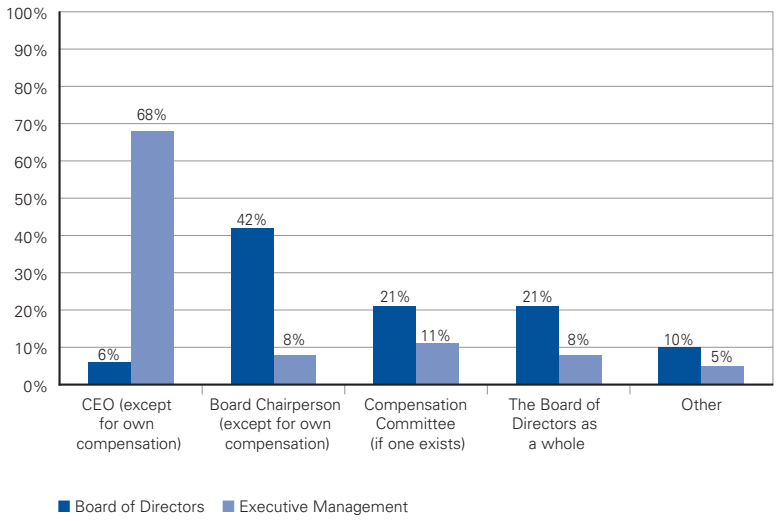
**Discussion of compensation by the Board of Directors**



*Compensation proposals are presented by the Board Chair and the CEO*

In most cases, the concrete proposal for compensation to the members of the Board is made by the Chairperson. The CEO usually proposes the compensation for Executive Management.

**Source of proposals for compensation**




*Compensation is defined short term*

In 78% of the cases, compensation for Executive Management is fixed for one year. In 15% of the companies surveyed, the term is more than three years. The Board of Directors is orientated more long term: 54% of the cases are fixed for a year and 24% for more than three years. In this respect, the question arises as to whether the «fixed» compensation is fixed at all or whether it is subject to regular adjustments.

A statistically significant connection between the existence of a Compensation Committee and the frequency with which compensation is adjusted could not be identified.

# 7. Type and structure of compensation

Compensation for management personnel is usually comprised of several components such as a fixed base salary, incentive driven bonuses, share options and pension credits. Depending on the composition and structure of the individual components, there is a varying incentive effect for the recipient and varying costs for the company. In addition, taxation and corporate legislative framework conditions have to be taken into consideration. The accounting and reporting standards which are applied stipulate how the compensation is to be included in the accounts and what has to be disclosed. A well constructed compensation package must represent a suitable compromise for the company and the manager, taking both sides into consideration.

### 7.1. Fixed and variable compensation

Fixed compensation is – as the name suggests – not directly dependent upon the performance of the individual or the success of the company. It is separate from current developments for the foreseen contractual period.

Since fixed compensation is more or less secure from the point of view of the recipient, its incentive effect is usually limited. A certain part of the total remuneration will, however, have to be granted in this form in order to satisfy the planning needs of the individual involved. Even entrepreneurial Board members and executive managers all share the need for job security. But in addition, fixed cash salaries are also subject to regular renegotiation, creating an incentive for the employee to achieve more than the absolute minimum described in his or her employment contract.

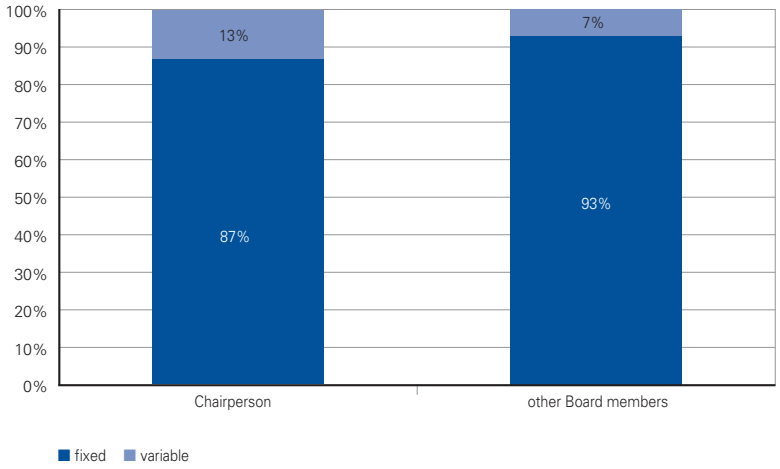
In contrast to fixed remuneration, the level of the variable components depends upon future developments which are unknown or unclear when an agreement is reached.

*For the Board of Directors, compensation hardly includes any performance incentives*

A glance at the values involved shows that variable compensation components are of practically no significance for members of the Board of Directors:[8]

[8] The question is often discussed as to the valuation of options granted. Since the options are not exercisable or based on monetary funds, a value of zero is sometimes allocated. The opportunities integral to an option become identifiable when upon being executed, high values are partially made apparent. The methodology of options valuation was not separately addressed in the survey. The declared values for the level of variable compensation components might therefore only be comparable to a limited extent.

**Proportion of variable compensation for Board members**




Additional findings were as follows:

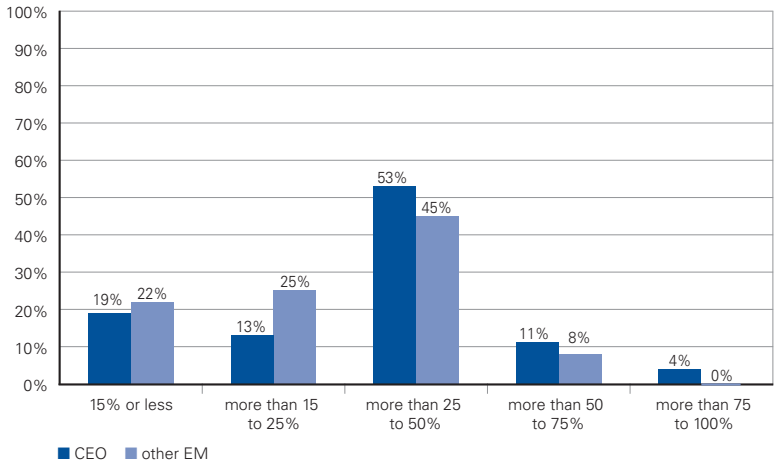
- In three out of four companies, there is no variable compensation at all for Board members, all allocations were fixed.
- In about three quarters of all cases, the Board chair and his or her deputy receive higher compensation than the rest of the Board.
- Professional experience and expertise play virtually no role in determining compensation.
- In 62% of the companies surveyed, the cash compensation was in the form of a fixed annual amount. In 33% of the cases, the fixed compensation was supplemented by a meeting fee. In 5% of the companies, only the meeting fee was paid.
- Membership in committees is only taken into consideration in about 30% of all cases. In half of those cases, payment is regulated by means of an additional meeting fee; the majority of the other half granted an additional fixed amount.

On the whole, the compensation structure shows significant potential for improvement. Most Board members today are paid neither on the basis of their capability, their performance nor the results they achieved. The compensation is therefore more akin to a «participation fee» which provides little incentive for extraordinary performance.

*Variable compensation factors play a major role for Executive Management*

In contrast to the Board of Directors, variable compensation factors play a major role for the members of Executive Management. Seen as a whole and on average, a third of the compensation paid to the CEO is variable, and the other members of group management are not far behind. The basis of the results is, however, very broad and indicates a large number of companies offering lower variable factors:

### Percentage of variable compensation for Executive Management

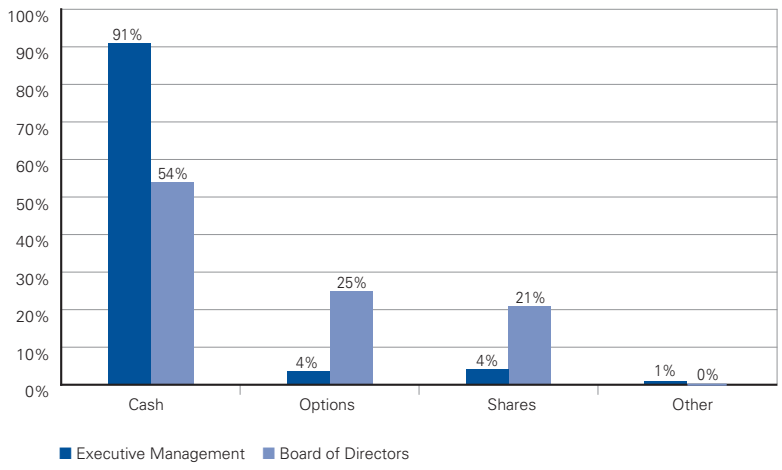



Statistically, publicly listed companies provided considerably higher variable compensation to the CEO than unlisted companies in the form of share-based compensation models which, due to the tradability of the shares, are very attractive. In association with the incentive effect of variable compensation, publicly listed companies therefore have a competitive advantage.

*Variable compensation for Executive Management is almost exclusively in the form of cash, while shares and options are important for the Board of Directors*

Most of the companies surveyed make use of a share or option-based compensation model, but in examining the individual components in terms of value, Executive Management prefers variable cash components. In compensation for the Board of Directors, the preference for cash payment is less pronounced, but nevertheless present.

### Distribution of variable compensation components by value



In about 10% of the cases, Executive Management can choose between a cash bonus and share-based compensation, while the Board is given the same choice somewhat more frequently.

### 7.2. Measurement of variable compensation

*Profit, yield and sales parameters are vital for determining variable compensation*

Companies have various forms of variable compensation at their disposal. The simplest form is that of cost-related remuneration, e.g. meeting fees, which vary depending on the amount of work performed by the individual for the company and remained fixed regardless of performance level.

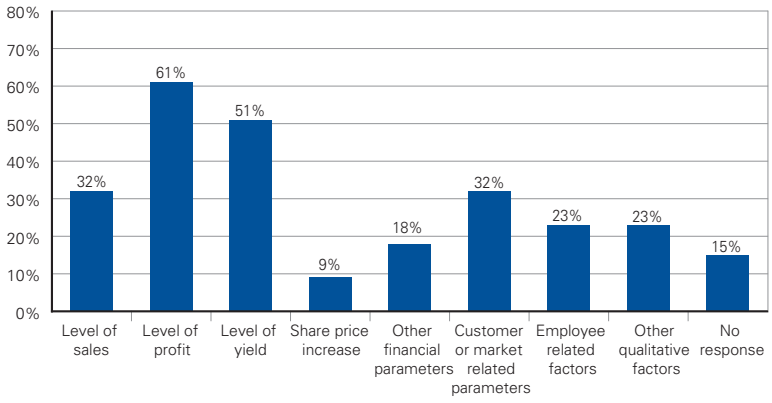
On the other hand, the interests of the shareholders are taken into account if the variable cash compensation is granted on the basis of results, i.e. its level depends upon the achievement of specific corporate targets. The interests of the company's management and the shareholders are then balanced.

Examples for basic financial parameters are the EBIT[9], EBITDA[10], net profit, growth in sales or Economic Value Added (EVA)[11]. The chosen target parameter depends on the strategic directives of the company and the core steering values derived:

- Pure focus on profit can push back medium and long-term objectives such as the assurance of market shares.
- If, on the other hand, the parameters are used to increasing market share, the management might detrimentally affect profitability.

In many cases, a combination of varying short and long-term factors is appropriate in order to minimize negative effects. Suitable in this regard are, in particular, yield parameters which place a number of elements in relation to each other. The following relative parameters are in use by the companies surveyed:

**Measurement parameters for variable compensation**




[9] EBIT is the abbreviation of Earnings Before Interest and Taxes.
[10] EBITDA is the abbreviation of Earnings Before Interest, Taxes, Depreciation and Amortisation of tangible and intangible assets.
[11] The Economic Value Added is calculated (in simplified form) as the profit remaining after deduction of the anticipated capital costs (lenders and shareholders).

Based on the multiple answers, it is clear that multi-dimensional target parameters are often used, which is a welcome phenomenon.

*Provision for group management incentives are aimed at remaining within the budget for the following year*

A primary deciding factor in about three quarters of the cases for measuring variable compensation is budget. Medium and long-term targets are of secondary importance. Changes in comparison with the previous year or comparison with other benchmarks play a secondary role. In around 90% of the cases, the objectives are defined for a period of one year. In approximately 10%, the outlook is between two and three years. Longer terms outlooks only exist in exceptional cases.

As a consequence of this short-term approach, one must assume that budgets are deliberately prepared with caution in order to increase the chances of achieving targets. This is, however, counter-productive for the company.

*The incentive effect of bonuses is often unclear; in many cases, there is leeway*

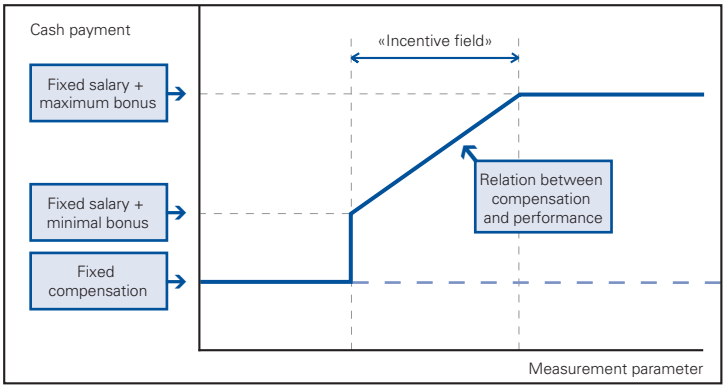
For reliability from all sides, it is advisable to grant additional bonuses based on a fixed formula. On the other hand, this may lead to special circumstances which are not accounted for in the formula. The result could be that managers might be rewarded or sanctioned for something for which they are not responsible. The solution is to introduce some discretionary leeway which, however, may present the risk of granting over-generous bonuses in order to maintain a stable pool of employees.

Practice shows that despite the associated risks, discretionary leeway exists in about half of the cases. Also in about half of the companies surveyed, a fixed formula is in place. Cases in which there are no fixed rules are extremely rare.

It can make sense to fix a lower limit to the level of resulting variable compensation. A lower limit acts in the same way as an additional fixed remuneration («guaranteed bonus»), however its additional incentive effects are questionable. It could be applied temporarily in special situations, for example during an intensive results driven research phase in which the management should show more flexibility.

The objective of a cap is to avoid a situation in which compensation rises to immeasurable levels during profitable times, placing consequently higher demands of managers. Nevertheless a cap can also have a negative impact on employee motivation because, although more success is achieved for the company, the individual manager receives no additional gratitude. A cap should therefore only be considered if an increase in profit is inevitable based on an existing phase of growth in the entire industry and unrelated to the efforts of the management.

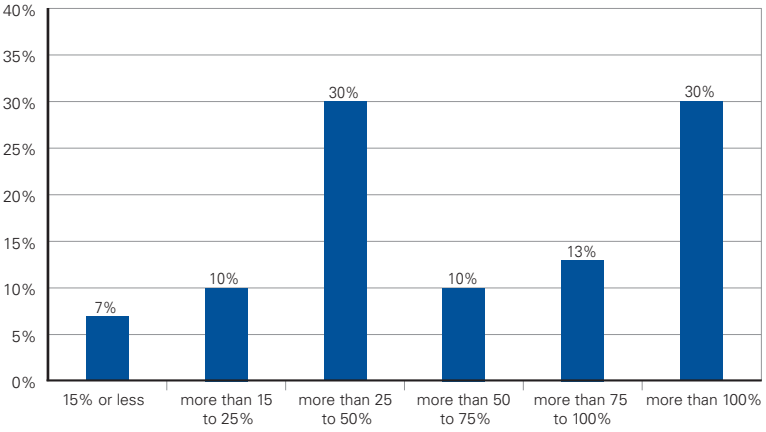
### Basic principle of a bonus with a lower and upper limit




*In the large majority of cases, the bonus is capped*

Bonus caps are particularly widespread; they are applied in about three quarters of the companies surveyed. The average highest bonus level is 84% of the basic salary, but the spread is very broad.

### Percentage level of bonus caps for Executive Management in relation to salary




A minimum bonus of about 20% is in place for the companies surveyed.

With lower and upper limits in variable compensation, it is important to ensure that targets which lie outside the fiscal year limits do not lead to a postponement of operational measures into the next year in order to benefit again in the variable segment. This can also be countered by a multi-period view, i.e. a positive or negative achievement result is credited or debited against the compensation measurements for the following year (the so-called «bonus bank»).

### 7.3. Share and option programs

*Shares and stock options*

Shares represent a direct shareholding position for the owner; he or she acquires part of a company. In contrast, stock options initially represent merely a right to a future shareholding position; they enable the owner to buy one or more shares at particular conditions in the future. For the owner of an option, it is of particular interest at which point in time (the exercise time) he or she can acquire the share and at which price (exercise price).

Depending on the specific structure, it can happen that share-based compensation structures provide significant liquidity advantages in comparison to cash remuneration. The granting of options is always liquidity-neutral for the company; in fact, when the rights are exercised, there will be an inflow of money. Even when shares are issued there is no outflow of money if the allocation takes place from newly created shares. If, on the other hand, the shares are bought back from the market and then handed to the employee, there is no difference in terms of liquidity in comparison to cash.

Due to the tradability of the papers, share-based compensation models exist particularly in publicly listed companies; the survey showed a statistically significant connection in this regard.

*Leverage effect*

An important difference between shares and options is the varying leverage effect:

If a share rises in price from CHF 20 to CHF 22, the relative growth value is 10%.

On the other hand, the owner of a right to acquire this share at a price of CHF 12 enjoys the intrinsic growth value from CHF 8 to CHF 10, i.e. 25%.

Options are therefore subject to higher relative fluctuation and thus represent a higher risk. If the share price falls to CHF 12, the shareholder suffers a loss of 40%. The intrinsic value of the option at that point in time, on the other hand, is zero, indicating a total loss.

It is also clear from this that because of the risks associated, stock options are basically more expensive than shares from the point of view of the company. In order to compensate for the higher risk, the employee will demand a higher value in options than if he or she had been given the corresponding amount in shares.

*Valuation of options*

Numerous theoretical approaches have been developed for the valuation of options. Among the most well known are the Binominal Model and the Black-Scholes Model. The valuation of shares for publicly listed companies takes place at the fair market value; for privately controlled companies, the parties involved must agree upon a suitable valuation of the company.

Options are described as being «in the money» if the current share price is higher than the exercise price. The owner can therefore achieve a profit. Conversely, they are called «out of the money» if the current price of the share is lower than the exercise price. The option will not then be exercised because purchasing the share over the market would be cheaper. The factual value of an option is always comprised of these two components: the intrinsic value and the time value.

- The intrinsic value is the positive difference between the current price and the exercise price. If the exercise price is higher than the current price, the intrinsic value of the option is zero.
- The time value represents the future potential of an option to achieve a profit. This depends on the volatility of the share and the term of the option.

Towards the end of the term, the time value of an option sinks to zero because the chance of future price gains dissipates. At the same time, the overall value of the option approaches the intrinsic value because the owner, at the point in time at which the option can be exercised, can cash the difference between the exercise price and the current price. Share options only have a value on being exercised if they are «in the money», but a share always has a value as long as the share price is above zero.

*Virtual and real papers*

For corporate or capital market legislative reasons, it might be advisable not to issue any real shares or options but to make use of so-called virtual papers (phantom stock/phantom options).

For the owner, virtual shares and options behave in the same economic manner as «genuine» papers, but do not include any participation in the company or the right to do so. There is merely a claim on compensation of the growths in value and the receipt of dividends in cash. The valuation is basically the same as that for shares and stock options, and the assertion of claims can be linked to certain conditions, depending on the needs of the company.

*Incentive mechanisms of shares and stock options*

The remuneration of senior management with shares and stock options is welcomed because manager and shareholders interests easily harmonize in regards to a sustainable increase in company value. Share and option programmes therefore have a long tradition as components of management compensation, particularly in the United States. The corresponding rights are frequently not only granted to the company's managers but are a fixed component of compensation conditions throughout the entire company.

Nevertheless, the use of share-based compensation also gives rise to certain risks. For example managers may be driven to push the share price up as high as possible during measurement periods in order to benefit from the related gains. Tactics used in recent years range from the targeted distribution of corporate press releases all the way to accounting irregularities in order to prevent any sinking

of the share price. It is therefore possible that shareholders suffer more damage than what is gained in motivation for company managers.

It needs to be noted, on the whole, that shares and options are particularly attractive for their recipients when prices are on the rise. This effect is strengthened even further by restrictions on transfers of ownership which are associated with most staff shares and options. A company which sails into stormy waters must, especially in this situation, expect that performance providers will leave the company because there is no likelihood that they will be able to profitably cash their shares and options. The specific conditions on the employment market and in other companies must also be taken into account. In recent years, this situation has often been countered by reducing the exercise prices (repricing) in order to revive the attractiveness of the programmes.

*The average vesting period is four years*

Shares as well as stock options can be linked with a wide variety of conditions, depending on the needs of the company. What matters most are the resulting incentive effects. Stock options are not usually granted on an irrevocable basis but only become an assertable legal claim after a certain period of time (the so-called vesting period) – four years on average. It can also be agreed that the options lapse if and when the employee leaves the company, which increases the binding of the employee to the company. In many cases, tranches are built with phased due dates so that every further year of employment with the company brings the employee an additional number of options. As a rule, stock options are not transferable, or vesting periods are agreed for shares, during which they cannot be sold. This is also designed to promote long-term binding.

Among the companies surveyed, the average vesting period is about four years.

*In most cases, the exercise price is equal to the market price at the time of issue; Indexation is rare*

Of central importance for the incentive mechanisms is the definition of the purchase price of shares or the exercise price of options. The employee will usually aim for a purchase or exercise price that is as low as possible to insure a certain degree of safety against future price losses and/or an increased chance of benefiting from price gain. From the point of view of the company, synchronizing the interests of shareholders and employees is guaranteed if the employee is hoping for future increases in the share price and is not sitting on a «safe cushion» which only makes share price losses initially noticeable on paper. However, the exercise price should not be so high that the employee comes to the conclusion that profitable is unattainable and therefore unattractive.

In 95% of the companies surveyed, the exercise price is equal to the current market price of the share when it is granted – a positive incentive effect for the investor.

In this regard, a useful benchmark is to index the exerciseability of options, i.e. rights can only be exercised at the end of their term if the share price increase lies above an appropriate comparable index. This means that only performance

which lies above the general market growth is rewarded and can therefore be attributed to the individual achievements of the management. However, indexing of this kind was extremely rare for those companies surveyed.

Commonly, most share-based compensation methods increase the number of issued shares and therefore change the ownership ratio of a company. Since, after exercising the rights, more share-holders are involved in the value of the company, this phenomenon is described as «dilution» of the previous shareholdings. From the point of view of the shareholders, this can, however, lead to a positive overall effect, if the measures undertaken to bind and motivate the employees contribute to an increase in the value of the company compared to what is lost through the dilution. Nevertheless, the assessment of costs and benefits in this regard is a very difficult task.

### 7.4. Fringe benefits

In addition to fixed salaries, bonuses, options and shares, senior managers may also receive additional payments and benefits. These may include a company car, apartment, club memberships, specially priced loans or guarantees. Other benefits might include life insurance, health insurance, loans to enable the exercising of stock options and more.

Even though these are not cash benefits, they are very similar in terms of their incentive value because they do not directly depend on the company's financial standing. However, some of these benefits hold a particular status for a manager and are a good way for a company to express its appreciation. For example, a particularly luxurious company car or an exclusive club membership can be more motivating for the recipient than a cash bonus.

*Company cars are generally made available to managers; loans at preferred conditions are granted on occasion*

In approximately three quarters of the companies surveyed, company cars are made available to the executive managers. Board members are granted a company car much more rarely – in only about one tenth of the cases.

In about one seventh of the companies, senior managers are granted loans at preferential conditions, it should be noted here however that no banks were included in the survey. Similar benefits for members of the Board are very rare.

Other fringe benefits such as apartments, health insurance or club memberships are of low significance.

### 7.5. Pensions and post-contractual benefits

A frequent form of compensation is a senior management pension which goes beyond the mandatory levels and which the beneficiary receives upon retirement.

These pensions can be defined in advance (defined benefits) or depend upon the credit balance of the beneficiary's personal retirement savings account (defined contributions):

- If the pension payments are regulated by defined benefits, they usually depend upon the years of service with the company and the income during that period.
- In the case of a pension structured by defined contributions, the company and the beneficiary pay fixed contributions into a pension fund from which the retirement benefits are then financed.

It should be noted that the difference between defined benefit and defined contributions plans can vary outside of Switzerland depending on local legislation. It is often the case that a pension plan classified in the category of defined contributions is regarded under IFRS as a defined benefits plan.

Pensions can be structured in various ways. They can, for example, be made available in the form of one-time capital payments, as time-limited pensions (e.g. AHV bridging pensions) or as lifetime annuities. Pensions can be constant or adjusted by inflation. Benefits can be restricted for payment only to former employees or extended to their surviving dependants.

Depending on their structure, pensions can generate various kinds of incentives in terms of management behavior:

- Pension regulations which enable early retirement (soon to be at the age of 58), can give managers the opportunity to retire from active employment long before the standard retirement age, making room for younger successors.
- With the necessary structuring of the pension regulations, early retirement can also be actively promoted, e.g. through a high incentive target plan from as early as 58 and through generous financial bridging until the standard retirement age is reached – an offer which would lapse if the employee decides not to take early retirement.
- In contrast, managers can be bound to the company until the standard retirement age if the reduction of benefits is very significant in the case of early retirement or if the pension regulations do not enable early retirement at all.

*Executive managers are often granted additional pension entitlements*

In the companies surveyed, significant additional pension arrangements, which go beyond what is required by law, are granted primarily to members of executive management, in about one quarter of the cases, yet corresponding grants for Board members are very rare.

Further benefits which a former top manager or Board member might receive after his or her retirement could, for example, include the continued availability of assistants, office space or a company car. From a business management point of view, expenditures of this kind only make sense if they are indispensable to

gain management personnel or for a positive imaging and networking effect, should the relevant person continue to be operationally linked to the company. In the survey, however, these elements did not come into play.

Noteworthy is the very low significance of the benefits mentioned above in terms of value. Together with the fringe benefits described in the previous section, they only represent about 7.5% of overall compensation for executive managers.

### 7.6. Severance pay upon termination

Much of the public debate in recent years has focused on severance pay. For members of Executive Management or the Board of Directors, compensation of this kind can be contractually agreed, in anticipation of an unplanned departure.

For the company, the incentive effect of this kind of agreement is often put into question since, in the end, a person is being paid for not being employed. Contractual arrangements of this kind are reasonable if termination is due to events which beyond the employee control, for example after a corporate takeover or in the case of a complete strategical redirection.

*«Golden parachute» agreements are insignificant in practice*

In the companies surveyed, there are practically no agreements with Board members regarding severance pay upon termination, or so-called «golden parachutes.» They only exist for members of Executive Management in one case out of five. In three quarters of these cases, the reasons cited were forced departure from the company (notice of termination), for the remaining cases it was due to the sale of the company.

*The level of severance pay granted by the companies surveyed was between one to two times the annual salary*

Apart from remuneration agreed in advance, it is also possible for additional «voluntary» severance pay to be granted on departure which, for most of the companies surveyed, amounts to one or two times the annual remuneration. This could motivate an employee to termination his or her contract early and waive any further claims. Payments of this kind often serve to avoid long-lasting, public argument and bad press for the company. What is sometimes overlooked is that excessive severance pay can also cause the same effect.

# 8. Level of compensation

The level of compensation for executive managers and Board members is one of the most sensitive topics in corporate management. It is all the more noteworthy that a good half of the questionnaires contained almost complete details about the total compensation level.

This is probably a result of the perceived significance of the topic and the pressure for justification with which the Board members and executive managers are confronted. About 80% of the participants are of the opinion that the discussion in recent years has given the subject of management compensation greater significance.

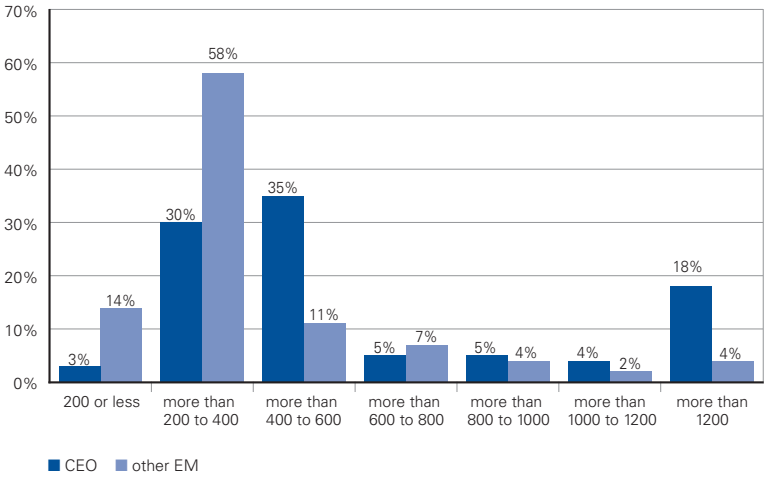
## 8.1. Compensation granted to Executive Management

*The majority of executive managers do not receive excessive compensation packages*

The average compensation for CEOs in the companies surveyed is approximately CHF 1.2 million (overall compensation including all fixed and variable components). The other members of Executive Management receive an average of CHF 0.88 million.

However, these relatively high average figures reflect a distorted picture of reality because they are influenced by a few exceptions at the top of the scale. If the two highest individual compensation figures are eliminated, the average sinks for the CEO to about CHF 657K and for the other members of Executive Management to CHF 381K. Approximately two thirds of the CEOs receive between CHF 200K and 600K.

**Absolute level of compensation to CEOs and other executive managers (in thousand CHF)**



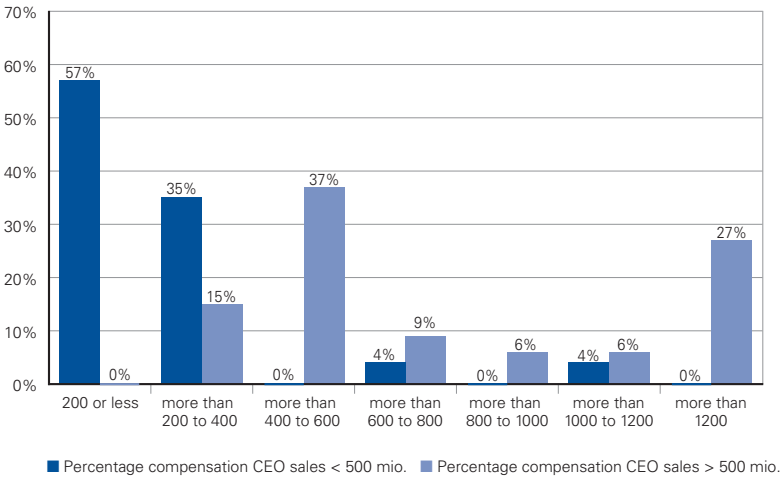

The highest individual compensation mentioned for a CEO was CHF 21.5 million. It is noteworthy that every fifth CEO has a compensation package of more than CHF 1.2 million.

The compensation level for the other members of Executive Management is largely between CHF 200K–400K. Major exceptions in terms of the absolute figure are insignificant here; it is apparent that the market for general Executive Management personnel is largely the same.

*The level of compensation depends on the size of the company*

It was possible to identify a statistically significant connection between the absolute level of compensation and the size of the company (sales, number of employees). The larger the company, the higher the compensation.

**Level of compensation granted to CEOs depending on sales (in thousand CHF)**



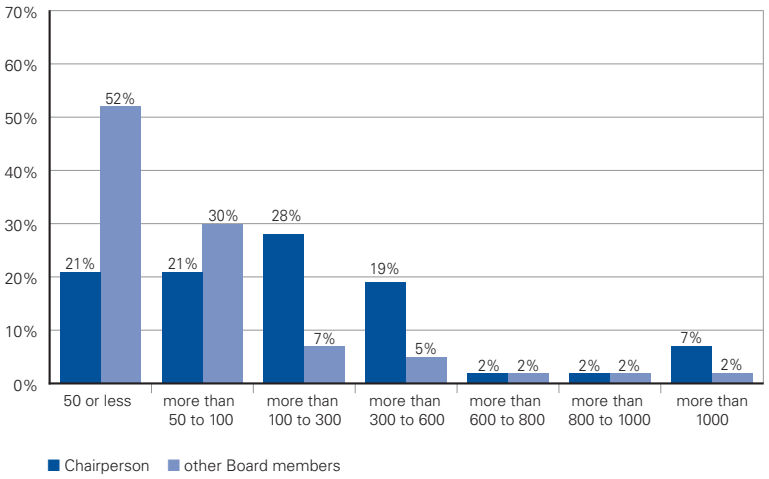

## 8.2. Compensation granted to Board members

*The large majority of Board members do not receive excessive compensation packages*

The average compensation for a Board Chairperson is around CHF 300K; other members of the Board receive approx. CHF 177K. In this calculation, the two highest individual figures were eliminated, as in the procedure for executive managers. Major exceptions exist primarily for the Head of the Board, whereas the compensation for other Board members is less diffused.

A Board Chair receives on average between CHF 100K–300K; the other members of the Board between CHF 25K–60K. A significant number of Board Chairs receive less than CHF 100K and many of the other Board members less than CHF 60K. The publicly held belief in excessive compensation certainly does not apply in these cases. At the same time, about two thirds of the participants in the survey are of the opinion that the demands made of Board members have increased in recent years. Roughly one half of them agree that the risk for Board members has risen.

**Absolute level of compensation to Board Chairs and other Board members (in thousand CHF)**




*A dual function leads to higher compensation, but also to better incentives*

Based on the available data, the compensation packages granted by companies with and without a separation of functions between the Board Chair and the CEO differ in a statistically significant manner. The compensation for activity as a CEO is higher if the same person is also Head of the Board, and the CEO is therefore personally involved as the Board Chair in defining his/her compensation. It must, however, be mentioned that the proportion of variable compensation in the case of this dual function is also statistically significant, giving rise to an improved incentive effect.

*The absolute level of compensation depends upon the time expenditure for a Board mandate*

It was not possible to determine a statistically significant connection between the time expenditure for a Board mandate and the absolute level of compensation granted. However, the compensation is partly comprised of a fixed and a variable component. Board members with a higher proportion of variable compensation spent considerably more time on this task than those Board members on fixed compensation. The incentive effect repeatedly attributed to variable compensation therefore holds true.

*Compensation Committees can lead to lower compensation*

The survey showed a connection between the relative compensation volume (level of compensation dependant on company sales) and the existence of a Compensation Committee. In those cases, the compensation paid by companies was lower than in those without a committee. The resulting figures were not significant based on the statistics in the study, but they were nevertheless noticeable. It is likely that the discussions held in a Compensation Committee lead to a generally more restrained compensation policy.

# 9. Accounting and reporting

### 9.1. Cash compensation and fringe benefits

*Inclusion in accounts and valuation*

According to the Swiss Code of Obligations (Art. 663, Para. 3 SCO), the Swiss Accounting and Reporting Recommendations (ARR 7) and International Financial Reporting Standards (IAS 1), cash compensation and fringe benefits paid to the company's management are to be recorded together with the remuneration paid to the remaining personnel and shown separately as personnel costs. If the compensation has not yet been paid out, the company must record a corresponding liability. If certain components of the cash compensation are only payable more than 12 months after the balance sheet date, the liability must be discounted, according to IFRS, to the cash value.

*Disclosure*

Neither the Swiss Code of Obligations (SCO) nor the Swiss Accounting and Reporting Recommendations (ARR) have required disclosure of information about cash compensation and fringe benefits to senior management until now.

On January 1, 2007, the amendment to the corporation law concerning transparency with regard to compensations to Board members and executive managers will enter into effect. Companies whose shares are listed on a stock exchange will then be required to declare in the notes to the balance sheet all compensations which have been paid out directly or indirectly to current members of the Board and Executive Management, including fees, salaries and bonuses. The regulations also demand the disclosure of outstanding loans, sureties and guarantees to current and former Board members and executive managers, albeit for the latter only if the loans are not at normal market conditions. The total amount of compensation and credit paid to Board members and executive managers is to be disclosed, as well as the amount paid to each Board member and the highest amount paid to a member of Executive Management, giving the names and functions of the relevant persons. Since the notes to the annual financial statements have to be included in the audit, the compensation packages for Executive Management and the Board for the 2007 fiscal year will be audited for the first time.

A comparable requirement has already existed since 2002 in the corporate governance guidelines of the Swiss Exchange (SWX) for all companies listed there.[12] This requires disclosure of the amount of all compensations paid out during the reporting period which flowed directly or indirectly to members of the Board and Executive Management. The amount of compensations is to be shown as a whole for the executive members of the Board and the members of Executive Management on the one hand and non-executive members of the Board on the other hand. In addition, the Board member with the highest overall compensation is to be indicated separately as a sum (without mentioning the name). If the members of the Board and Executive Management have been granted additio-

[12] Effect for companies headquarted abroad, only if their equity securities are not also listed in their home country.

nal loans from the company, they must be shown separately as governing body loans. In addition, information is to be provided on additional fees, e.g. for consultancy services.

All this data is to be published in the annual report in a separate corporate governance chapter. At the same time that the new transparency regulations governing share transactions go into effect on January 1, 2007 the regulations concerned corporate governance guideline will be waived. Companies headquarted abroad, for which the corporate governance guidelines are applicable, must comply with the new transparency regulations. Furthermore, once the new transparency regulations go into effect these companies must openly present any additional information on the contents and procedure of remunerations and participation programs in the corporate governance chapter of their annual report.

Since 2005, the International Financial Reporting Standards also require under IAS 24 «related party disclosures» the summary disclosure of compensation to managers in key positions. This definition, however, depending on the organizational structure, also includes additional members of management as well as family members of the people mentioned.

### 9.2. Share-based compensation

*Inclusion in accounts and valuation*

Neither the Swiss Code of Obligations (OR) nor the Swiss Accounting and Reporting Recommendations (ARR) have foreseen a special regulation for share-based compensation in the past. The granting of options is therefore not currently shown at all in the balance sheet and the profit and loss account. It is, however, possible to book them, and this is becoming increasingly the case. Issuing shares to employees is only then to be booked as a personnel cost if they are issued from the company's own stock of shares shown on the asset side of the balance sheet (SCO). ARR 24 requires that the company's own shares must be shown as deductions from equity and that purchases and sales are handled without effecting profit, i.e. any discount granted to the employee in comparison with the market price is offset directly against the reserves. A similar situation exists if the shares are issued as part of a capital increase. The price paid by an employee increases the current assets and the equity, but a possible discount off the current market price is not taken into consideration. The granting of options connected with available stocks by means of a capital increase often leads to no expenditure according to commercial law. In practice there are nevertheless numerous cases, particularly within a company, in which a later increase in capital authorized by employee options can lead to expenditure.

The treatment of share-based compensation under IFRS is regulated in IFRS 2 «share-based payments» and goes a significant step further. If an employee is paid in the form of shares or stock options (so-called equity-settled transaction), their fair value is to be recorded as personnel expenditure. Valuation takes place

at the point when the rights are granted; a subsequent adjustment to changed market conditions is not foreseen. IFRS 2 assumes that the performance will be provided across the term of the vesting period and that the conditions (performance and service conditions) will be met during that period. The costs resulting from share-based payment are therefore recognized on a straight-line basis over the vesting period. The contra entry for the expense booking is in equity. The simultaneous cost entry reduces the profit but the total sum of equity is not affected by the transaction, however in the income statement the employee job performance will be noted and the profit is therefore reduced.

The use of virtual shares or virtual options is subject to the same recording mechanism as described above. The costs are distributed over the vesting period and the liability is additionally valued at fair value on each balance sheet date.

*Disclosure*

Neither the Swiss Code of Obligations (OR) nor the Swiss Accounting and Reporting Recommendations (ARR) have foreseen the disclosure of information on shares and options of senior management in the past.

On January 1, 2007, the amendment to the corporation law concerning transparency with regard to compensations to Board members and executive managers will enter into effect. Companies whose shares are listed on the stock exchange will be required to declare in the notes to the balance sheet all compensations which have been paid out directly or indirectly to current members of the Board and Executive Management. Compensation in this regard includes the granting of participations, conversion and option rights. Furthermore, due to this change, publicly listed companies must disclose in the notes to the balance sheet the company involvement as well as the conversion and option rights of every current member of the Board and Executive Management, providing the name and function of each person.

A similar requirement has already existed since 2002 in the corporate governance guidelines of the Swiss Exchange (SWX) for all companies listed there. This requires disclosure of the amount of all compensations which have been paid out during the reporting period and flowed directly or indirectly to members of the Board and Executive Management. Real as well as virtual ownership of shares and an overview of the allocated stock options are to be shown separately together with details of the year in which they were allocated, the term, drawing relationship and exercise price. A further requirement is that the shares and options owned by related private individuals and legal entities as per Art. OR[13] must be declared.

[13] According to Art. 678 OR a related entity is defined as an entity sharing a close personal or economic, legal or factual binding with a Board member. This can apply to private individuals as well as legal entities. In the case of a close personal relationship (e.g. father – daughter) or with two companies within the same group, «related parties» are assumed.

Since 2005, IFRS has foreseen under IAS 24 disclosure of the total of all share-based payments to key management personnel. According to IFRS 2 the additional disclosure of information with regard to the type and scope of the programmes, the valuation of the various instruments, as well as the impact on financial reporting is required. Disclosure under IFRS 2 applies, however, for all share-based payments made by the company and not exclusively to senior management.

### 9.3. Pension contributions and post-contractual benefits

*Inclusion in accounts and valuation*

Until now, the Swiss Code of Obligations (SCO) has not foreseen any special regulations for pension contributions which go beyond the basic duty to include existing uncertain obligations in the accounts (Art. 669, Para. 1 SCO). On the other hand, the Swiss Accounting and Reporting Recommendations (ARR) as well as the International Financial Reporting Standards (IFRS) have created very detailed special regulations in ARR 16 and IAS 19.

The presentation of defined contribution plans is relatively simple in the accounting under IAS 19. The ongoing contributions paid by the company lead to personnel expenditure, accompanied by an outflow of payments. There are no resulting long-term liabilities; it is always a case of short-term obligations which are settled within short periods of time.

With a defined benefit plan under IAS 19, recognition is complex and involves actuarial calculations. The pension obligation, based on the actuarial calculation, is recognized in the income statement over the remaining service period of the employees or, in respect to the actuarial gains and losses, recognized with equity. Assumptions must be made (and regularly updated) with regard to interest rates, death rates, fluctuation and future salary and pension increases. According to IAS 19 termination benefits are to be recognized as personnel expenditure for the company in the period in which the payment obligation arises.

Costs which are incurred by the company due to further benefits to former employees, such as the use of a company car, must, according to IAS 19 generally be provided for via the income statement until the point in time at which the employee leaves the company, because in most cases, no future, clearly allocated performance is expected from the employee. Under the principle of actual period profit calculation, a proportional increase over the period of service is a possibility.

The regulations of Swiss GAAP ARR 16 have completely changed as of January 1, 2006 (retroactive to January 1, 2005). There is no differentiation between defined contribution and defined benefit plans. In assessing the financial impact of pensions on companies, the basis is newly built by the annual financial statements of the pension funds because, as from January 1, 2005, these also have to be prepared under the principles of a «true and fair view» as per Swiss GAAP ARR

26 allowing for a direct assessment of any economic benefits or obligations of the company.

*Disclosure*

The Swiss Code of Obligations (SCO) demands merely that the obligations to pension funds are recorded in the notes.

Under IFRS, the pension arrangements granted to all employees are to be described and the significant actuarial assumptions are to be disclosed (IAS 19). Furthermore, the cash value of the defined contribution obligations, the evidenced fair value of the plan assets as well as the individual components of the positions shown in the profit and loss account and the balance sheet must be disclosed in the notes. As of January 1, 2006 disclosure requirements are more far-reaching. The duty of disclosure applies to all pension funds, and not only those for senior management. Only IAS 24 demands that the pension contributions and termination benefits paid out to management in key functions have to be shown in the notes as separate total sums. Moreover, the pension foundation itself qualifies as an related party, meaning that all transactions between it and the company have to be disclosed in the consolidated financial statements.

Disclosure as per Swiss GAAP ARR 16 is in table form in the notes to annual financial statements and is separated between employer contribution reserves on the one hand and economic benefit or obligation on the other hand. The required information per pension fund has to be separately presented and any capitalization of an economic benefit must be explained.

On January 1, 2007, the amendment to the corporation law concerning transparency with regard to compensations to Board members and executive managers will go into effect. Companies whose shares are publicly listed will then be required to declare in the notes to the balance sheet all compensations which have been paid out directly or indirectly to current members of the Board and Executive Management. Compensation in this regard includes termination benefits as well as costs which give rise to or increase the claims to pension benefits. In addition, compensation to former members of the Board of Directors or Executive Management must be disclosed in the notes if the person was formerly activity in a governing body within the company or if the compensation is not in accordance with the market standard.

A comparable requirement has already existed since 2002 in the corporate governance guidelines of the Swiss Exchange (SWX) for all companies that are listed there. According to these guidelines, all the expenses incurred in the reporting period for pension benefits are a component of the overall management compensation which is to be disclosed by the company. Moreover, the corporate governance guidelines demand that all benefits that the company paid to former senior managers must be disclosed. These include the pensions which are paid directly by the company and one-time payments such as termination benefits.

# 10. Taxation

### 10.1. Cash payments

Cash payments such as meeting fees and bonuses as well as payments in kind become subject to income tax and social insurance contributions at the point in time at which they are paid out or granted. The company must declare them in the salary statement for the employee or in a special form for Board members. With the introduction of the new salary statement, the compensations for Board members will only have to be declared with the salary statement.

For the purposes of corporate tax, the costs which arise for the company in the financial year in which the payments or grants take place qualify as tax-deductible personnel expenditure.

### 10.2. Share-based payment

The taxation of genuine employee participations such as shares and stock options, with which the employee has the right to draw a share, is currently regulated by a circular issued by the Federal Tax Administration. In addition, Swiss parliament recently debated the taxation legislation of employee participations and sent it back to the Federal Treasury for further clarification on questions of possible tax and social insurance losses. It is not yet clear when the new law will take effect.

*Employee shares*

In the circular as well as in the new federal law, employee shares are subject to tax and social security contributions at the point in time at which they are allocated. The fair market value of the share at the time of issue is a decisive factor, and if there are any blocked periods before the share can be sold, a discount of 6% per year is granted. The granting of this tax discount is politically very controversial because of the perceived tax advantage for managers who often receive stock options at a favorable rate. This treatment, regarded by some political parties as unfair to «normal» employees, is giving rise to a referendum and has pushed the Federal Treasury to prepare a corresponding study.

*Stock options*

As far as stock options are concerned, the taxation and interpretation of the circular mentioned above has not been regulated in a standardized form by the individual cantons. Most of the cantons levy tax on stock options at the point in time at which they are exercised. The difference between the fair market of the share on the day it is exercised and the exercise price builds taxable income from gainful employment activity. The social security system also follows this practice. Individual cantons tax the stock options when they are allocated, and value calculated by means of an option price model gives rise to taxable income. The federal law on the taxation of employee participations will lead to harmonization of the cantons and options will then be taxable, as a rule, when they are exercised.

*Virtual programmes*

Artificial employee participations, such as virtual shares and virtual stock options, are already treated as cash compensation in practice today as well as in the new law on employee participations and are therefore taxable when they are paid out.

*Deductible costs*

Administrative costs incurred by a company in granting employee participation programmes represent tax-deductible personnel expenditure or other costs. On the other hand, the costs associated with making the shares available are only tax-deductible if the relevant costs have been booked in the company-only financial statements as per SCO. However, that is only the case if the issuance of shares or fulfillment of option rights takes place from the company's own shares which have been bought back and which appeared as financial assets on the asset side of the balance sheet. If the necessary shares are made available by means of a capital increase, tax deductibility is controversial because the capital dilution takes place merely at the shareholder level. However, in practice, the cost is increasingly booked in statutory accounts, meaning that a deduction taxation point of view is also expected.

### 10.3. Fringe benefits

All payments or special benefits from the company to the employee, such as discounts, payments in kind or insurance premium compensation, are qualified as taxable income for the employee arising from gainful employment. The company is obliged to disclose all the payments and benefits in the salary statement. Particularly the new salary statement, which is expected to become mandatory as of fiscal year 2007, obliges the employer to draw up a detailed list of all payments and special benefits.

For the company, the costs which arise from granting fringe benefits represent tax-deductible personnel expenditure.

### 10.4. Pension contributions and post-contractual services

Social insurance contributions to the AHV and IV (Retirement and Surviving Dependants' Insurance and Disability Insurance) as well as occupational benefit funds in accordance with the Swiss BVG are tax-deductible for the employee. On the other hand, all benefits, such as pensions and capital payments made from social insurance funds represent taxable income for the employee at the point in time at which they are paid out. Capital payments from a pension fund in accordance with the BVG are taxed at a privileged rate under certain preconditions.

The third package of the first BVG revision, which took effect on January 1, 2006, affects various situations which are relevant from a taxation point of view. Above all, the insurable salary has been given a capped (currently CHF 774,000) and more restrictive regulations have been declared regarding tax-deductible buy-ins

into occupational benefit funds. Furthermore, from now on early retirement is basically only possible from the age of 58.

Capital payments or pensions from a mixed, re-purchasable, free pension fund (Pillar 3b) represent liable taxable and social insurance income for the employee if the premiums or deposits in the insurance were financed by the company and the insurance policy includes a revocable beneficiary clause for the employee. If, on the other hand, the benefit to the employee is irrevocable, only the insurance premiums paid by the company form a component of the salary are subject to tax and social security insurance. The payment of the pension or the capital to the irrevocable benefit of the employee is then tax exempt under compliance with certain conditions.

Termination benefits or other benefits in kind, such as a personal assistant, office space or a company car, quality as taxable income for the employee. In the case of termination benefits, privileged taxation can apply under special conditions which are regulated in a detailed circular.

The costs incurred by the company in association with the benefits described above represent tax-deductible personnel expenditure for the company.

# 11. Legal framework conditions

### 11.1. Cash payments and fringe benefits

*Corporate law*

With the exception of a regulation regarding the now unusual profit participations for Board members or «tantiemen»,[14] corporate law does not include any specific stipulations with regard to the type, measurement and payment of cash compensations and fringe benefits to members of the Board and Executive Management. However, when structuring compensations, particular attention should be paid to the behavioral duties of Board members and the capital protection regulations.

Basically the Board of Directors is responsible for structuring the compensation to members of the Board of Executive Management.[15] In this process, it must protect the interests of the company in good faith (duty of loyalty under corporation law). If the Board of Directors pays excessive remuneration which clearly no longer reflects the performance and the norms on the market and therefore damages the company, the Board violates its duty of loyalty under corporation law. This can give rise to corresponding liability on the part of the Board.

With regard to compensation paid to Board members themselves, the theory today is that personal performance, the position within the Board (handling of special duties, involvement in committees) and personal risk should be taken into consideration.

If the compensation granted to members of the Board is obviously disproportionate to the work performed, this might give rise to claims by the company to reimbursement from the relevant Board members.

*Employment law*

The employment law is applicable for the relationships between the company and the members of Executive Management as well as those members of the Board who are also active as management employees on a part-time or full-time basis.

Fixed cash compensation and frequently also fringe benefits within the framework of an employment relationship represent salary. A bonus as part of the employment relationship can represent a component of salary as well as a payment awarded in special circumstances (gratuity). The differentiation is important because the salary is subject to all protection stipulations under employment law, which is not the case for gratuities. Refusal to pay a pro-rated bonus to an employee who leaves the company in the course of a year can infringe upon the retention ban or reduction of salary for work already performed if the bonus is qualified as a component of the salary.

Apart from the manner in which they are described in the employment contract, the criteria for differentiating between salary and gratuity form the basis for the

[14] A profit share or tantieme to Board members requires a basis in the Articles of Incorporation and may only be granted by resolutions at the annual Shareholders' meeting, after allocation to the legal reserves and the advance distribution of a dividend of 5% to the shareholders.

[15] The Articles of Incorporation can stipulate that the annual Shareholders' meeting defines the compensation to the Board of Directors.

structuring and determination of their level. If measuring the achievement of predefined targets – salary tendency. If measured at the discretion of the employer – gratuity tendency. The size of the bonus in relation to the basic salary leads to salary tendency in the case of a large bonus and the frequency of payment leads to salary tendency in the case of regular payments.

### 11.2. Share-based payment

*Corporate law*

For share-based payments, the Section 11.1 comments are analogous. In addition, the following should be noted:

If the company is not already in possession of the shares which it intends to hand out within the framework of share-based payment, it must either increase its capital or buy back its own shares.

If a capital increase is chosen, a conditional capital increase is particularly suitable for option programs. In this case the capital is only increased when it is needed, i.e. when the option is exercised. For share programs, the alternatives are authorized or ordinary capital increase. In these cases, the subscription right of existing shareholders has to be withdrawn, which requires a significant cause. The participation of employees is explicitly named in the law as a possible significant cause for exclusion of the subscription right.

If the programs are to be served by buying back the company's own shares the relevant stipulations must be observed. Freely disposable equity must be available at the level of the buy back, and the proportion of treasury shares (= own shares) may not exceed 10% of the share capital (a further 10% can be acquired with transfer restrictions, but must be sold again within a period of two years). For its own shares, the company must separately record, as a reserve, an amount equal to the purchase value. In purchasing the shares, the company must also observe equal treatment of the shareholders. This is particularly the case if the company buys its shares back via the stock exchange (to the extent that the shares are listed) or makes a repurchase offer to all the shareholders and acquires the shares from those willing to sell in proportion to their share ownership.

*Employment law*

For share-based payments, the Section 11.1 comments are analogous. In addition, the following should be noted:

As in the case of variable cash compensation, the qualification of compensation as salary or gratuity is of major importance for share-based payment (virtual or factual rights). Due to the ban on salary retention for work already performed, a regulation is probably not allowed under which shares or options, which have already been allocated and qualify as salary components, lapse without compensation when the employment relationship comes to an end, e.g. because the vesting period has not yet expired. If, for a certain period of time, the employee

cannot make use of shares or options that have been allocated and qualify as salary components because there is a blocking clause, the danger exists, according to two relevant decisions of the Swiss Supreme Court, that such an arrangement can be qualified as null and void for the employer salary application (an infringement of the so-called «truck prohibition»).

### 11.3. Termination benefits

*Corporate law*

Severance pay to members of the Board of Directors and Executive Management at the time when their mandates or employment arrangements end (so-called golden handshakes) or when control over the company changes (so-called golden parachutes) must lie within the interests of the company. This is probably not the case if the benefits are not in tune with the market or performance. The payment of termination benefits which are not in the interests of the company represents an infringement of the duty of loyalty under corporation law and can lead to corresponding liability of the Board of Directors.

*Employment law*

The employment law is applicable for the relationships between the company and the members of Executive Management as well as those members of the Board who, apart from their function on the Board are also active as management employees on a part-time or full-time basis.

If the employment relationship ends for an employee who is at least 50 years old after 20 or more years of service, the employer must basically pay him or her a severance amount equal to at least two monthly salary. If, however, the employee receives benefits from a pension fund, these can be deducted from the severance pay, to the extent that the benefits were financed by the employer or by means of its allocations to the staff pension fund. Since the BVG and the law on Free Transferability came into effect, the legal claim to termination pay is only relevant to the extent that the employer's payments in terms of occupational pension are lower than the termination pay allowed by law, which is rarely the case today. Deviations from these stipulations are possible to any extent, if they are in favor of the employee.

### 11.4. Pension benefits

The regulations of occupational pensions are detailed in several Switzerland legislations. The basis for all those laws is established by Art. 111 of the Federal Constitution in which the three pillar principle, and therefore also the occupational pension is anchored.

As the case in point here is the occupational pension, certain regulations are included in the employment law (Art. 331 et seq. SCO). Since the large majority of pension funds in Switzerland have the legal form of a foundation, further le-

gal regulations regarding occupational pensions are contained in Art. 80–89bis of the Swiss Civil Code (SCC).

The actual pension law is included in the Federal Law on Occupational Retirement, Surviving Dependants' and Disability Pension (BVG) and in the Federal Law on Free Transferability in the Occupational Retirement, Surviving Dependants' and Disability Pension (FZG). The basic BVG entered into effect in 1985 and the FZG in 1995. There is a large number of ordinances for both these laws, the most important one being the Ordinance on the Occupational Retirement, Surviving Dependants' and Disability Pension, the BVV2. Both these laws experienced several significant amendments and supplements with the 1st BVG revision, implemented in three stages from 2004 until 2006.

The BVG and its ordinances regulate the mandatory, i.e. minimum arrangements in occupational pensions. The parties involved – and therefore the employers – may go beyond this minimum level of retirement pension, the so-called superobligatory pension. The relevant regulations are also contained in the laws mentioned above.

# 12. Industry opinions

### 12.1. Statements and quotations

*«As a Federal Councilor, it is not up to me to comment on whether certain managers earn too much or not. That is up to the companies, not politics. My wish is that a company's owners – meaning the shareholders in the case of a corporation – should be placed in a position in which they can exercise their interests as owners ... The shareholder has to have the necessary information available and be able to express his or her will without falsification ... Legal definition of salaries, ceiling limits and so on are nonsense.»*
Federal Councilor Christoph Blocher in an interview with *Finanz und Wirtschaft,* June 3, 2006

*«You cannot argue that a top manager in Switzerland should be paid the same as for example someone in the US. That logic doesn't hold.»*
FDP National Councilor / Board Member Georg Fischer / Swiss Life Gerold Bührer in an interview with the *Handelszeitung,* June 21, 2006

*«We all accept that a good boss should be well paid. But please – within reason. We try to convince the relevant managers with our appeals that they should subordinate themselves to the overall interest and exercise restraint on a voluntary basis.»*
Johann Schneider-Amann, President of the Swissmem Industrial Association, in an interview with the *Sonntagszeitung,* April 2, 2006

*«The economic system in Switzerland does not recognize any degree of freedom for entrepreneurs and managers. That is regarded as an advantage for the location ... the development of management salaries is leading to a loss of trust on a wide front. If the business leaders fail to get a grip on this problem, the political consequences, such as more regulation all the way to salary restrictions ... will not take much longer to appear.»*
Press release *Travail.Suisse,* the umbrella organization for employees, June 30, 2006

*«Huge amounts like that are simply ridiculous ... Those people shouldn't act so greedy and only be motivated by money. They all earn enough after all ... It jeopardizes the social acceptance of our system. Actually, only about half a dozen salaries are involved ... but the general public doesn't accept it when someone who makes multi-millions tearfully announces that we've got to save.»*
Nestlé Honorary President Helmut Maucher, quoted in *Blick,* May 26, 2006

*«Most systems do not have a reasonable approach and timeline that is necessary for the development of the company.»*
Dr. Stephan Hostettler, Compensation consultant, supplement to *Bilanz,* June 2006

*«Those who invested in the concerns with the best paid managers have not always done well.»*
Assessment by Daniel Hug in the *NZZ am Sonntag,* March 12, 2006, in which the performance of the shares of a large majority of Swiss companies with the best paid managers lay below the SPI Index

*«No boss of a group works better – more or less intelligently – if he earns twenty instead of two million.»*
Dirk Schütz, author of the book Gierige Chefs («Greedy Bosses») on zeitenwende.ch. Dirk Schütz is the chief editor of the business magazine *Cash* and former deputy chief editor of *Bilanz* and *Wirschaftswoche*

*«The salaries and the salary debate in Switzerland have reached the highest level of perversion – I don't want to hear or read anything more about them.»*
CEO of a listed group of companies with sales of about CHF 1 billion

### 12.2. Interview with Ethos

Ethos is a foundation, established by Swiss pension funds, which has set itself the objective of making investments under consideration of sustained developments, supporting shareholders in the active exercising of their voting rights and promoting the dialogue with companies. The interview was conducted with Mr. Dominique Biedermann, Director of the Ethos Foundation and of Ethos Services SA.

**It is repeatedly suggested that the annual shareholders' meetings should decide on the compensation of the Board of Directors and/or Executive Management. Do you think this makes sense?**

**Dominique Biedermann:** Unfortunately, the Board members in a few companies haven't done their job correctly, which is why we need additional control mechanisms. But shareholders shouldn't interfere with daily business. It is therefore not a question of individual compensation but of the general salary policy. It is the responsibility of the Board to present a salary system to the shareholders. The annual shareholders' meeting should be able to vote, at least in a consultative capacity. A regulation of that kind might be, for example, that the fixed salary cannot lie above the average of a certain industry. Another regulation could be that the variable components can only amount to a maximum of twice the fixed salary. Approval of the salary policy by the annual shareholders' meeting has functioned very well for the last four years in England, for three years in Holland and in Sweden since this year. Nevertheless, there are extreme cases as well – we are not alone in Switzerland with the problem.

**Is independence sometimes missing in the work of Board members?**

**Dominique Biedermann:** I find it problematic when a small part of the Board decides everything. Particularly when those people aren't independent, the balance of management and control no longer functions. The process of decision-making is no longer optimal. A further problem is the dual function of a simultaneous CEO and Board Chair. That situation shouldn't exist – except in temporary, exceptional situations.

**An important question is the structuring of compensation. Here, above all, the role of stock options is repeatedly criticized. How do you see it?**

**Dominique Biedermann:** Options should be an incentive and contribute to a rise in the share price. As shareholders, we basically agree, however, there are a few problems which repeatedly appear. First of all, the valuation has to be correct. There is often talk of the tax valuation, while the fair market value is quite different. Secondly, it is important to structure the system so that performance is rewarded if it is really exceptional. Gains which result from a general economic development are not the merit of a company's management. In England, for example, options are only granted if the underlying performance criteria are above average for the industry. In Switzerland, that hasn't yet been understood; the argument here is often that the systems are too complicated. And here, as with the entire remuneration, the incentive shouldn't be too high. In the final analysis, it is the shareholders who pay.

**Termination benefits such as «golden parachutes» are constantly being criticized. What needs to be observed here?**

**Dominique Biedermann:** In this discussion, one must define, above all, what a golden parachute really is. Compared internationally, a golden parachute already exists if an employment contract is concluded for a period of more than a year. A longer-term employment contract is, in a sense, a hidden golden parachute. Even a year is too much in those cases in which there is actually a «reward for failure.»

**Transparency is constantly being demanded. How far should it go?**

**Dominique Biedermann:** From 2007, it is foreseen that for the Board of Directors of publicly listed companies, the individual compensations are to be disclosed. For Executive Management, two declarations are to be made – «en bloc» for the entire Executive Management team and then, in addition, the highest individual compensation, usually for the CEO. We believe that this is a welcome development. But I think the situation for the companies which are not listed on the stock exchange looks different. In those cases, the members of the Board should normally give enough information if the shareholders ask for it. But really only if they ask for it.

# 13. Outlook and conclusion

The subject of management compensation will continue to remain a hot topic. Rising demands made on executive managers and Board members, an ever higher risk for their reputation and personal assets as well as the increasing internationalization and dynamism will influence the «Market for Managers» in Switzerland over the long term. Within the framework of the survey, future trends and developments were therefore also identified.

*The most important instrument of compensation will continue to be cash payment; the importance of shares and options in particular has suffered badly in recent years due to the development of the capital market*

With regards to structuring compensation, current developments will continue. For executive managers, cash bonus will become more prominent in the future, with fixed compensation in second place. For Board members, the situation is reversed. The importance of shares will remain more or less unchanged; most of the respondents to the survey believe that the importance of options is in decline. There are several possible explanations for this trend. Apart from the disappointing developments on the capital markets which have often wiped out the value of option rights and the sometimes negative image effects due to excessive option grants, it is possible that recognition in the profit and loss account as required in the future may play a role. Fringe benefits will retain their subordinate importance.

*The compensation for Board members will tend to rise but will remain unchanged for executive managers*

About half the respondents to the survey believe that compensation for Board members will rise in the next few years. A quarter of them do not foresee any further increase and the other quarter is undecided. Only one in five respondents believes that there will be a further increase for executive managers; about every third respondent thinks that there will be no further growth.

*Success-dependent compensation will not assert itself any further*

Only about 20% of the respondents tend to believe that the compensation for executive managers will depend more strongly on the success of the company in the future. More than 40% believe that success-dependent compensation will not be of any higher significance than it already is today. As far as compensation of Board members is concerned, more than half the respondents share the view that there will be no further increase in the flexibility of remuneration. This is all the more noteworthy against the background that the Board of Directors currently does not usually receive any variable compensation.

*The annual shareholders' meeting should refrain from involving itself in defining compensation*

About three quarters of the respondents reject the notion of letting the annual shareholders' meeting decide on the level of compensation for Executive Management. A majority also rejects involvement of the annual shareholders' meeting in fixing the compensation for Board members. A stronger inclusion of shareholders is only favored by an average of every fourth respondent.

*A middle ground is desired for disclosure requirements*

Disclosure of the compensation paid to every individual member of Executive Management and the Board is only favored by slightly more than every sixth respondent. It is noteworthy that only about every tenth respondent does not wish to disclose anything at all; people are therefore generally prepared to provide information. The large majority prefers a middle ground, whereby summary disclosure of the overall compensation without any additional details is

clearly preferred. A split of the individual granted compensation into its components or the additional disclosure of the highest individual compensation is regarded as the optimal solution by about one fifth of the respondents.

*From a corporate governance framework, only general compensation requirements are expected*

About half of the respondents hope that a framework concept for corporate governance includes only general regulations or none at all with regard to the structuring and definition of compensation. Only a small minority is in favor of clear and detailed regulations. Noteworthy is that there was no statistically significant connection between acceptance of the regulations and the level of compensation, i.e. it is not the case that the company representatives with higher compensation favor more or less regulation.

**The authors' conclusions in view of this study:**

In general terms, management compensation in Swiss practice is not in the sorry state that the current discussion in certain sections of the media would have us believe. At certain points, there is a clear need for improvement, given that the processes and instruments applied are already very appropriate in some instances. Specifically:

- For members of Executive Management, a mix of fixed and variable compensation at a ratio of «one third to two thirds» can already be described as very balanced. There is a clear need to act in terms of Board members where the current compensation structure is hardly appropriate for the rewarding of personal commitment and success.
- Share-based and option-based approaches are not very widespread at the moment – «cash is king.» This is regrettable because share-based compensation can make a sensible contribution to harmonizing the interests of shareholders and management as long as the instrument is not abused (e.g. repricing). The downward developments on the capital markets and the numerous scandals about such programs have evidently left their mark. It would be desirable to take a somewhat different stance with regard to shares and options as instruments of compensation in order to make use of their advantages, in combination with other components of remuneration.
- Against the background of the requirements for good corporate governance, the process of defining compensation is clearly in need of improvement. In far too many cases, the individuals involved are present when the decisions are made, and therefore hinder an open discussion taking place. Compensation Committees, remuneration guidelines and external consultants who can contribute objectivity and stabilize the process are seldom involved. Furthermore, an active communication policy which creates transparency with regard to the principles of the compensation model would be welcome. More proactive communication with the shareholders is of particular importance.

- The period of time for which compensation is defined is too short. With one-year periods of incentive remuneration, the danger is very high that medium and long-term considerations take a back seat. However, as in the case of share-based compensation, a reasonable extension of the timeframe gives rise to significantly more complexity, and most companies today are apparently wary of confronting it.
- The level of compensation for executive managers can, normally, be regarded as completely reasonable. The demands made of Board members will continue to rise due to today's complex and dynamics economic and business situation. This development will require a growing need of commitment for Board members which should also be reflected in their remuneration, which today is very moderate. Particularly an increase in the currently very low variable compensation for the members of the Board could provide more incentives to perform. A few individual cases lie far outside the normal framework, but that will be unavoidable in a free economy.
- With regard to the basic independence of management and control and the resultant balance of power, the structures of Executive Management and the Board of Directors are largely appropriate. The joint function of CEO and Board Chair appears to be a model in retreat; its disadvantages are now also becoming clear in family-owned companies.
- The international «Market for Managers» only plays a role in a few exceptional cases. In the definition of compensation in Switzerland, Swiss circumstances are still as fundamental as ever. A little more self-confidence would probably not harm those who grant compensation that is apparently too low.
- Termination benefits should only be paid in exceptional cases, such as in a takeover situation. Strategic reorientation, restructuring etc. are part of the activity of management. Those members of management who cannot or will not tow the line should not be entitled to affect the bottom line while standing in the way.

The study has shown that apart from the pure level of compensation, there are many other factors which deserve thought. In order to progress, it would be sensible if public debate were not restricted to the absolute level of compensation paid to a few high-profile individuals. There will always be those who go far beyond the norm. Imperative to the functioning of an economy is faith in a system that functions as a whole, and that should be encouraged.

**Published by**

KPMG
Badenerstrasse 172
P.O. Box
8026 Zurich

Order Code: 011 621 (English)
011 620 (German)

kpmgpublications@kpmg.com
Tel. +41 44 249 31 31
Fax +41 44 249 25 92
www.kpmg.ch

«Management Compensation in Swiss Business Practices» is published in English and German.

Concept: KPMG
Design, Prepress, Print:
Heer Druck AG, Sulgen

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**Head Office**
CH-8026 Zürich
Badenerstrasse 170/172
P. O. Box
Tel. +41 44 249 31 31
Fax +41 44 249 23 19
www.kpmg.ch

**Deutschschweiz**
CH-5001 Aarau
Mühlemattstrasse 56
Postfach 2701
Tel. +41 62 834 48 00
Fax +41 62 834 48 50

CH-4003 Basel
Steinengraben 5
Postfach
Tel. +41 61 286 91 91
Fax +41 61 286 92 73

CH-3000 Bern 15
Hofgut
Postfach
Tel. +41 31 384 76 00
Fax +41 31 384 76 47

CH-6039 Root/Luzern
D4 Platz 5
Tel. +41 41 368 38 38
Fax +41 41 368 38 88

CH-9001 St. Gallen
Bogenstrasse 7
Postfach 1142
Tel. +41 71 272 00 11
Fax +41 71 272 00 51

CH-6304 Zug
Landis+Gyr-Strasse 1
Postfach 4427
Tel. +41 41 727 74 74
Fax +41 41 727 74 00

**Suisse romande**
CH-2800 Delémont
Rue de la Maltière 10
Case postale 575
Tel. +41 32 423 45 10
Fax +41 32 423 45 11

CH-1701 Fribourg
Rue des Pilettes 1
Case postale 887
Tel. +41 26 347 49 00
Fax +41 26 347 49 01

CH-1211 Genève 12
Chemin De-Normandie 14
Case postale 449
Tel. +41 22 704 15 15
Fax +41 22 347 73 13

CH-1002 Lausanne
Avenue de Rumine 37
Case postale 6663
Tel. +41 21 345 01 22/21
Fax +41 21 320 53 07

CH-2000 Neuchâtel
Rue du Seyon 1
Case postale 2572
Tel. +41 32 727 61 30
Fax +41 32 727 61 58

**Ticino**
CH-6900 Lugano
Via Balestra 33
Tel. +41 91 912 12 12
Fax +41 91 912 12 13

**Liechtenstein**
LI-9494 Schaan
Landstrasse 99
Postfach 342
Tel. +423 237 70 40
Fax +423 237 70 50
www.kpmg.li