Appendix 1

Introduction

In the five years that have elapsed since the publication of the *«Swiss Code of Best Practice for Corporate Governance»* by economiesuisse and the Corporate Governance Directive by the SWX Swiss Exchange, questions surrounding the compensation of Boards of Directors and senior managers of public companies have become the focus of attention. This has manifested itself in a number of developments:

— As an advance part of the ongoing revision of company law in Switzerland, the new articles 663b^{bis} and 663c para. 3 of the Swiss Code of Obligations have entered into force. Above and beyond the Corporate Governance Directive, these require details of remuneration and loans to members of the governing bodies of listed companies to be published, in addition to any participation rights these members hold. All aspects of this issue are to be audited in the future by auditors;

— A law has been in effect in the United Kingdom since 2002 which provides for a consultative vote by shareholders on the compensation report of the Board of Directors. In other countries too, this type of solution to involve shareholders has either been adopted or is under discussion;

— Political initiatives in Switzerland – including parliamentary measures and a popular initiative that is still at the signature phase (the so-called «Minder» initiative) – address the issue of compensation for the governing bodies of public companies;

— Both in the US and in the EU, legal initiatives have been implemented or are being prepared which aim to increase transparency of compensation to members of governing bodies, and which for the most part expand the remit of the Shareholders' Meeting by giving it a say in the matter.

This is sufficient reason for once again reviewing the recommendations set out in *paras. 25 and 26* of the *Swiss Code* (on compensation committees and compensation policy) and reflecting on the corresponding suggestions put forward in the report by Prof. Karl Hofstetter. [1] *Para. 26* of the *«Swiss Code»* does actually already set out some key principles of a compensation policy that would work in the interests of shareholders and companies alike, and these retain their validity. There is, however, evidence of a need to make these principles more concrete and to develop them further in the light of experience gained over the last five years. This is treated in the following Appendix to the *«Swiss Code»*.

[1] Karl Hofstetter, Fünf Jahre Swiss Code of Best Practice, Sonderbericht zur Frage der Entschädigung von Verwaltungsrat und Management in Publikumsgesellschaften [Five Years of the Swiss Code of Best Practice – Special Report on the Issue of Compensation for Boards of Directors and Senior Managers in Public Companies], Zurich 2007, www.swissholdings.ch

Recommendations on compensation for board of directors and executive board

The *Appendix 1* set out here clarifies and expands the provisions of *paras. 25 and 26* of the *«Swiss Code of Best Practice for Corporate Governance»* with updated recommendations on the issue of compensation for members of Boards of Directors and Executive Boards. This *Appendix 1* is considered an integral part of the *Swiss Code*, and takes precedence over the text of March 25, 2002 insofar as any differences exist, particularly with respect to requirements for the *independence* of members of compensation committees (hereinafter Para. 2).

Appendix 1 to the *Swiss Code* can offer neither binding regulations nor a generally applicable formula for resolving questions arising in conjunction with compensation to members of Boards of Directors and Executive Boards in public companies. It should, however, set out recommendations for responsible treatment of these issues that have now become a focus of socio-political discussion – and are likely to remain so for some time.

Of key importance here is the need to stress that it is for business and companies to assume responsibility. Given the context of a liberal economic system, the aim cannot be to issue regulations governing the type and extent of compensation that should apply for Boards of Directors and senior managers. The task of corporate governance provisions should be to draw attention to guidelines and ensure transparent procedures which are free of conflicts of interest and geared to market realities. The way in which compensation is determined for senior managers and Boards of Directors must be comprehensible to shareholders. The endeavours undertaken by Boards of Directors will ultimately prove crucial in ensuring that the compensation levels that apply to directors and senior managers find acceptance among the wider public, and also of course among the employees of the companies in question.

a The Compensation Committee of the Board of Directors and its role

1 The Board of Directors passes a resolution on the compensation system and determines the responsibilities of the Compensation Committee

- The Board of Directors passes a resolution on the design of the compensation system for members of the Board of Directors and the Executive Board, as well as on guidelines for the design of retirement benefits for the executive members of both bodies.
- Furthermore the Board of Directors sets out the extent to which a Compensation Committee is assigned full resolution authority, the authority to make decisions subject to ratification by the body as a whole, or authority to submit proposals. In doing so the Board of Directors generally reserves the right to approve the overall compensation for the Executive Board and the compensation of the Chief Executive Officer.
- The Compensation Committee keeps the Board of Directors abreast of its deliberations during the latter’s meetings, and reports to it at least once a year in detail on the development of the compensation process and the Committee’s experience; where necessary it proposes the requisite changes to the compensation system.

2 Only independent members of the Board of Directors sit on the Compensation Committee

- The Compensation Committee appointed by the Board of Directors must not include any members with interlinked company mandates. Such a situation is deemed to exist if a committee member responsible for co-determining the compensation of a member of the Board of Directors or member of the Executive Board is himself/herself subject to the supervisory or directive powers of a member in another company.
- Independent members of the Board of Directors who are themselves, or represent, significant shareholders may be members of the Compensation Committee.

b The compensation system

3 The Compensation Committee is entrusted with the task of developing a proposal for the structuring of a compensation system for the top executives and board members of the company according to the directives of the Board of Directors

- The Board of Directors instructs the Compensation Committee on the basic elements of the compensation system for members of the Board of Directors and the Executive Board; this system should be simple, clear and reproducible.
- The company offers overall compensation commensurate with market conditions and aligned to performance in order to acquire and retain individuals with the necessary skills and character.
- The compensation system is designed in such a way that the interests of senior managers are aligned with the interests of the company.
- The Committee also strives to ensure reproducibility with respect to the practical application of the compensation system.

4 As a rule, the compensation system contains both fixed and variable components; it rewards conduct aimed at medium- and long-term corporate success with compensation elements available at a later date.

- Where the compensation system consists of both fixed and variable elements for individuals in executive positions, it should be structured in such a way that the variable component is in reasonable relation to individual performance on one hand, and sustainable success of the company or of a corporate unit on the other.
- The assessment of the variable compensation component is based on reproducible criteria; leadership qualities less easy to measure should also be taken into account. The variable compensation elements are cancelled or reduced if the relevant targets are not met.
- The Board of Directors determines whether or not share-based compensation is awarded as well. In this case the Board considers the different effects of allocating shares on the one hand and options or similar instruments on the other.
- Where share based compensation is concerned, the Committee ensures the timeliness of such compensation. As a rule, it tailors the immediately available elements of the compensation package to the attainment of short-term

targets; elements of the compensation package dependent upon the attainment of medium- or longer-term goals should be vested or blocked for a number of years.

5 **The compensation system is structured in such a way as to avoid the allocation of advantages not objectively justifiable or false incentives**

— The Compensation Committee takes care to ensure that the system does not set any unintended incentives or contain any components that could be influenced counter to their objectives.

— When drawing up employment contracts with members of the Executive Board, any unusually long notice periods or contract durations are to be avoided except in specific situations.

— Options on shares of the company are granted with a strike set at the same level or preferably higher than the average market value in question over a determined number of trading days prior to the day of granting.

6 **As a principle, the company does not grant «golden parachutes» or severance compensation**

— As a principle, the compensation system rules out any «golden parachute» arrangements applying in the event of a change in the company's control, as well as any severance applying in the case of termination of an employment contract at any other time («special benefits»). Not considered as special benefits in this sense are:

a benefits arising from provisions which – in the event of a change of control – permit eligible persons early vesting of deferred vested shares, options or other rights with due consideration of the principle of equal treatment, and

b the standard processing of existing obligations (including bonus payments envisaged by the compensation system) in the event of a termination while under contract.

— Special benefits granted in the event of a change in the company's control or other circumstances can only be justified if they are in the company's interests, and if they represent remuneration for exceptional services to the company for which the individual in question has not already been compensated in some other form. If the Board of Directors exceptionally provides for a special benefit in advance, it does so under this condition.

— The company discloses any special benefit that is agreed or awarded to cover the case of a change in company control or the premature departure of a member of the Board of Directors or Executive Board.

7 **The Compensation Committee scrutinizes salary comparisons with other companies as well as the work of external and internal consultants.**

— Where the remuneration practices of other companies serve as a comparative yardstick, the Committee undertakes a critical review of the composition of this peer group and of the conclusiveness of the comparisons drawn for its own compensation. It excludes from the peer group any companies that would skew the comparative results, either because of a lack of corporate governance or for any other valid reason.

— If the Committee brings in external consultants to make comparisons and recommendations in the area of senior executive compensation, the Committee itself decides on the consultant to use, issues the mandate, and determines the fee. It evaluates the results critically.

— If the Committee orders comparisons to be undertaken by the staff of its own company, these staff must be subject to the instructions of the Committee Chairman.

c Role of the Shareholders' Meeting

8 The Board of Directors produces a compensation report for the Shareholders' Meeting annually

— The compensation report describes the compensation system and its application in the business year under review. It illustrates also in tabular form, how the system has impacted the value terms over the period under report for individual Board members, the overall Board of Directors, the Executive Board as a whole, and the latter's most highly-remunerated member.

— The report shows the key criteria that have been used in measuring the variable elements of remuneration, and the mechanism that has been applied for valuing shares and share options according to the relevant rule system.

— The compensation report specifies the external consultants that have been used in connection with compensation issues and describes the comparisons that have been made.

9 The Board of Directors involves the Shareholders' Meeting in the debate on the compensation system in an appropriate form

— The Board of Directors decides how to involve the Shareholders' Meeting in the debate on the compensation system.

— As a rule, it selects one of the following options:

Option 1
The compensation report is brought into the discussion during the agenda items. *Approval of the Annual Financial Statements or Discharge to Board of Directors.* The Chairman of the Board or the Chairman of the Compensation Committee comments on the compensation report as well as the compensation system and then answers any questions. The resolution to approve the annual financial statements and the resolution of discharge are taken by the shareholders in knowledge of the details provided in the compensation report and the comments of the Chairman of the Compensation Committee.

Option 2
The Board of Directors puts the *compensation report* – which provides information on the compensation system adopted by the Board Directors and sets out in more detail the compensation awarded to senior executives in the business year in question – *to a consultative vote* at the Shareholders' Meeting

d Transparency

10 The Board of Directors ensures transparency with respect to the compensation of the members of the Board of Directors and the Executive Board

- The Board of Directors ensures that the compensation report sets out the company’s compensation system in a manner that is readily comprehensible.
- The compensation report is structured so as to make clear in particular which compensation payments have been awarded to the members of the Board of Directors, the Executive Board overall, and the latter’s highest-paid member for the business year and why these compensation payments have either fallen or risen in the business year.
- The Board of Directors may issue the compensation report separately, as part of the annual report, or as part of the corporate governance report.
- As details on remuneration and loans to members of the Board of Directors and the Executive Board must appear in the appendix for legal reasons, they may simply be mentioned by means of a reference in the compensation report if the details are not considered of importance to the report’s statements.