Issuer feedback on "European Pay for Performance Methodology"

From Agnès Blust Consulting Ltd., prepared jointly with:

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This letter is a joint response of the companies mentioned above to the request for comments regarding the European Pay for Performance (P4P) Methodology within the ISS policies for Europe, U.K. & Ireland. While we have reservations to these policy enhancements from a Switzerland perspective we appreciate the opportunity to comment on the methodology.

Question 1 - *Do you believe that investors should consider both the quantum of pay and pay for performance alignment when voting on remuneration related resolutions at the general meeting?*

Under Swiss legal provisions investors are already considering quantum through their binding AGM votes. **We remain concerned about binding vote recommendations which may be purely based on a P4P formula.** To date the P4P peer group selection in Europe has, in our view, not proven to be sufficiently robust. Furthermore, we think that the model overemphasizes TSR as the sole metric of executive performance and stewardship.

Overreliance on formula-based recommendations would be particularly harmful for smaller issuers in Switzerland. The binding nature of the AGM votes on executive compensation can put a firms' ability to attract and retain a strong leadership team at risk.

Furthermore, the proposed methodology calls implicitly for the disclosure of additional "realized pay" figures. In Switzerland this data would stand side by side with the traditional performance year disclosure (compensation report), retrospective approval figures (binding vote), prospective approval figures (binding vote) and reconciliation tables between the above (compensation report). These views will relate to different calendar periods and contain confusing information in the best case. In the worst case, they will appear contradictory to casual readers.

Question 2 - *What would you consider as a reasonable explanation by a company for justifying an apparent misalignment between pay and performance?*

In 2012 ISS introduced a quantitative methodology to assess pay-for-performance alignment for the US market. This US methodology is based on "disclosed pay" which is significantly more robust than the "realized pay" approach chosen for Europe.

Newly appointed CEOs from the outside tend to receive only base salaries and cash incentives for the initial years (in terms of "realized pay"). After a few years, LTI awards start to vest and therefore the "realized pay" figure increases gradually. This leads to systematically swelling "realized pay" figures, regardless of company performance and TSR. Even newly appointed CEOs from within the company will follow this pattern, albeit at a less pronounced level. Therefore, the pay/performance analysis may only start to reveal true potential P4P misalignments for CEOs who have been serving for more than 4-5 years. Given that the average CEO tenure in Europe has continuously come down over the last decade, we think that this will provide a reasonable explanation on apparent misalignment between performance and pay.

By contrast, the disclosed pay approach used in the US has the advantage of reflecting actual pay for performance decisions by a company's Remuneration Committee for a given year.

Further, using relative TSR as the sole indicator to measure P4P seems to be a rather narrow definition of performance. Companies that invest in their future growth, maybe at the cost of their short-term profit, may be see their relative TSR decrease as such strategic investments usually take a longer period of time to be reflected in the share price. Therefore, we favor a broader definition of performance, which can best be provided and explained by the Remuneration Committee of the company, rather than calculated by a statistical methodology.

Question 3 - *Do you believe that significant misalignment between pay and performance or pay substantially above median may reveal potential governance risks?*

Misalignment will generally not be indicative of potential governance risks. Boards take great care when determining executive pay while taking their firms' specific business challenges and managements' longer term achievements into account, particularly in well governed firms. Therefore, actual pay will from time to time deviate from a purely "model-derived" longer term trajectory.

Furthermore, the P4P methodology is based on statistical methods which would call for significance and hypothesis testing steps. This matters in a diverse European environment where a company's benchmarking sample populations can be biased in many ways (e.g. currency translation, differences in corporate law, prevalent company ownership structures or socio-economic context etc.). A particular concern for Swiss companies are the currency distortions under the inflated valuation of the Swiss Franc. Compensation levels must be considered in an internal year-on-year context as much as cross-industry/cross-country. To the extent that pay levels were to follow purchasing power shifts, these developments would have a relatively slow pace. While TSR metrics continuously reflect currency valuations, the executive pay levels will inevitably be far less elastic.

Finally, the comparison to median relies on a peer group. The selection of the peer group is a delicate matter, especially comparing compensation levels across countries and/or industries may be difficult or inappropriate. We believe that the Compensation Committee is best knowledgeable to determine the most relevant comparator companies and that an formula-driven methodology is not appropriate.

Based on the above, we are of the opinion that the European corporate landscape remains too diverse to draw conclusions on the quality of governance from P4P correlations.