HCM Executive Compensation Study

Executive Summary for Banks & Financial Services

September 2020

hcm.com

Copyright © 2020 by HCM International Ltd. All rights reserved. Not for further use, reproduction, or distribution without the express prior written permission of HCM International Ltd.

Key findings

2019 Total direct compensation

CHF 1.91 million for CEOs

CHF 0.84 million for EB members

- For the Swiss Top 100 banks and financial services, total direct compensation (TDC) for 2019 has increased (+33.6%) for CEOs and decreased (-3.7%) for EB members at median compared to 2014.
- At median, the pay level for CEOs was 1.8 times higher than for EB members, however, comparably, the difference has decreased over the last five years (2014: 2.0 times).

Variable compensation in % of total

55% for CEOs

52% for EB members

- As regards the compensation structure, it can be inferred that the portion of variable pay for CEOs and EB members has increased since 2014 by 3 percentage points (PP) and 5 PP, respectively.
- Particularly, in 2019 a larger part of variable pay was granted as long-term compensation (61% for CEOs, up by 7 PP, and 54% for EB members, up by 5 PP compared to 2014).

Performance measurement for immediate variable compensation

93% combine individual & corporate metrics

39% have a target bonus approach

- Typically, companies use more than 5 metrics to determine the immediate variable pay. Yet a fourth of companies can still be observed to be using a single metric only.
- Earnings measures and qualitative performance (incl. behavior and risk aspects) continue to be the most widespread metrics.

Funding of long-term awards

58% performance-driven grants

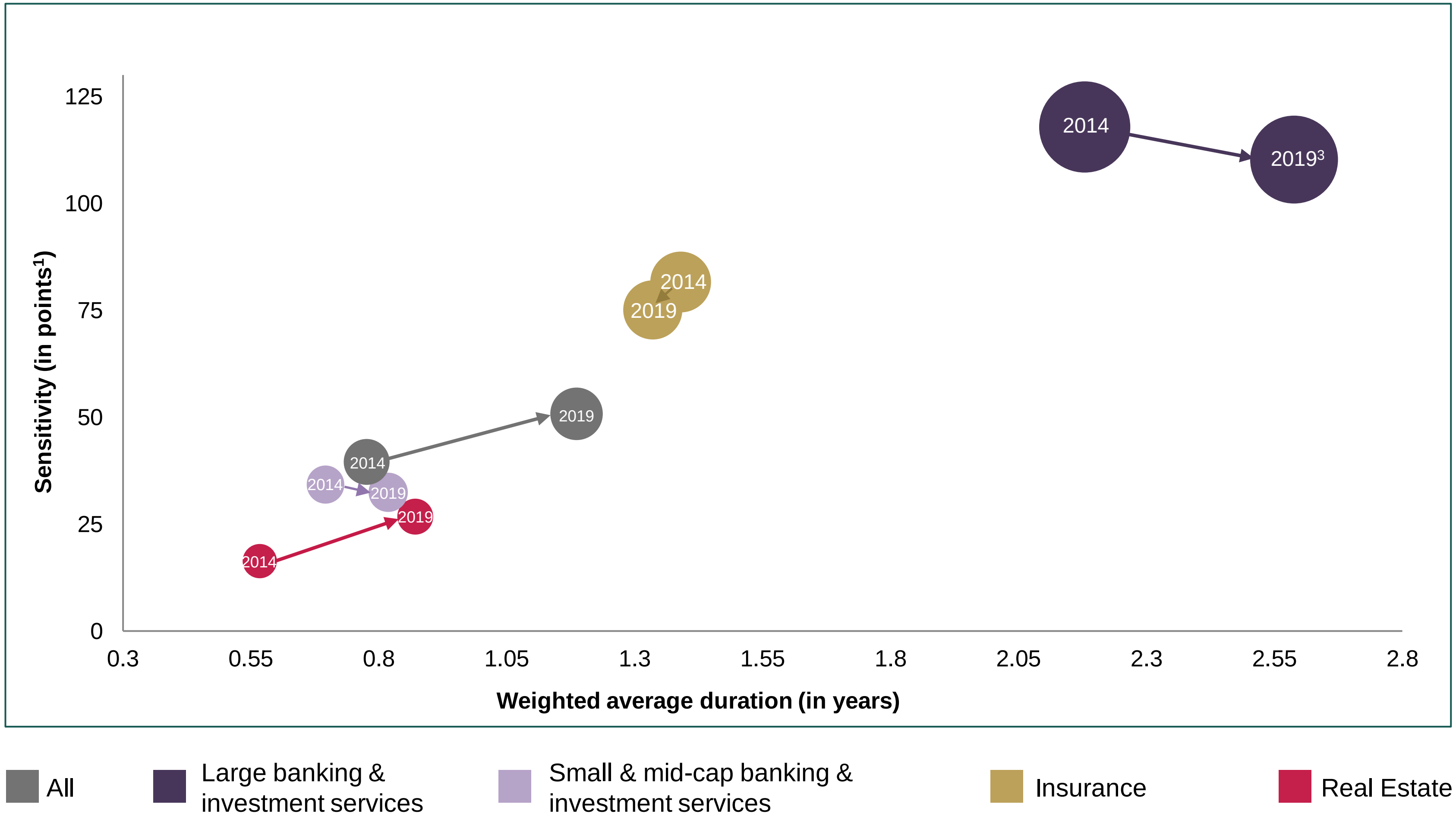
42% stand-alone grants

- When granted based on past performance, long-term awards are typically designed as blocked share awards while stand-alone grants are rather awarded in terms of performance shares.
- For determining the vesting of long-term plans, companies largely use 1-2 performance metrics, with TSR being the most prevalent one.

Overall, more long-term focus and increased sensitivity of compensation packages

HCM International

Sensitivity and duration of Total Direct Compensation, 2019 vs. 2014



- The riskiness of executive TDC can be assessed based on:
  - weighted average duration (in years) and
  - sensitivity to corporate performance (in points[1]).
- Note that the sensitivity and duration of pay commonly increase with compensation level (bubble size[2]).
- A closer look at the 2019 results shows that overall, executive pay packages have been deferred for a longer period (+0.4 years) and are more sensitive to risk (+11 points) when compared to 2014.

1.100 points correspond to the sensitivity of a blocked share instrument. 2. The size of a bubble corresponds to the total direct compensation of Executive Board members (including CEO). 3. Includes two banks with implicitly leveraged plans, which are herein rated as downside plans for consistency. Data source: respective Compensation Reports 2019 for market data.

Outlook for 2020 in consideration of COVID-19

- In 2020, the economy has largely been and continues to be affected by COVID-19.
- Based on HCM market insights, financial services firms generally have come less under pressure in terms of the economic situation due to COVID-19 when compared to other industries.
  - For example, only a few have taken remediation measures such as short-time work ("Kurzarbeit") and there were hardly any dismissals or restructuring efforts as a direct consequence of COVID-19 impacts.
  - Still, some financial companies already took measures, also as a response to regulators' requests. For example, some larger banks have split dividend payments subject to liquidity considerations.
- While the impacts on compensation for 2020 are still under discussion, they will, among other considerations, depend on the actual performance of each company.
- So far, only a few financial companies reduced executive fixed pay – and even then, mainly due to external/internal signaling effects and cost/liquidity considerations. However, the overall sentiment is that yet still, only a limited amount of financial companies plan to adjust their STI and/or LTI plans due to COVID-10 impacts.

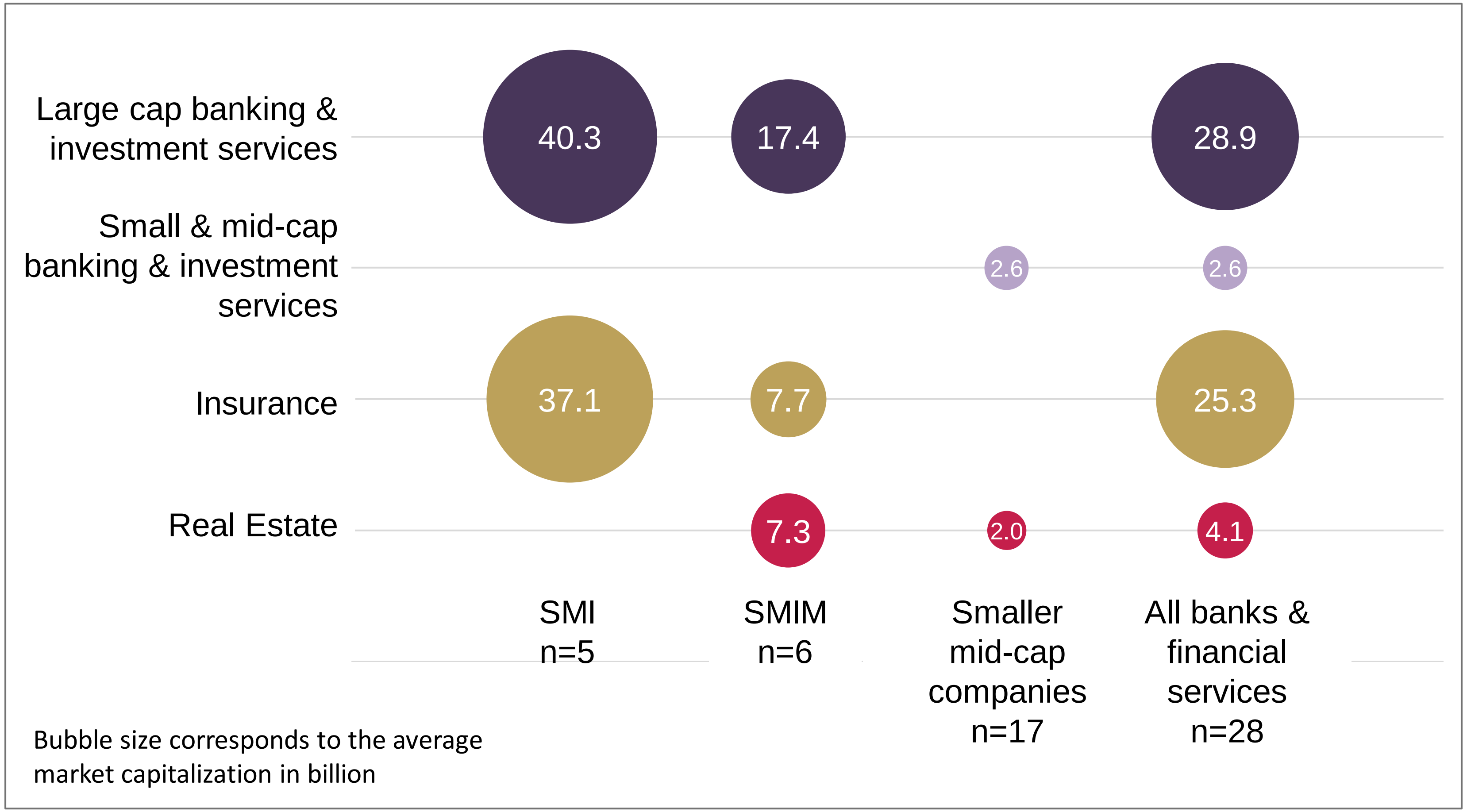
Agenda

1 Data Sample and Methodology
2 Compensation Level
3 Compensation Structure
4 Variable Pay Design
5 Shareholding Requirements
6 About HCM International

Data Sample and Methodology

Data sample

Sample of companies by sector and size

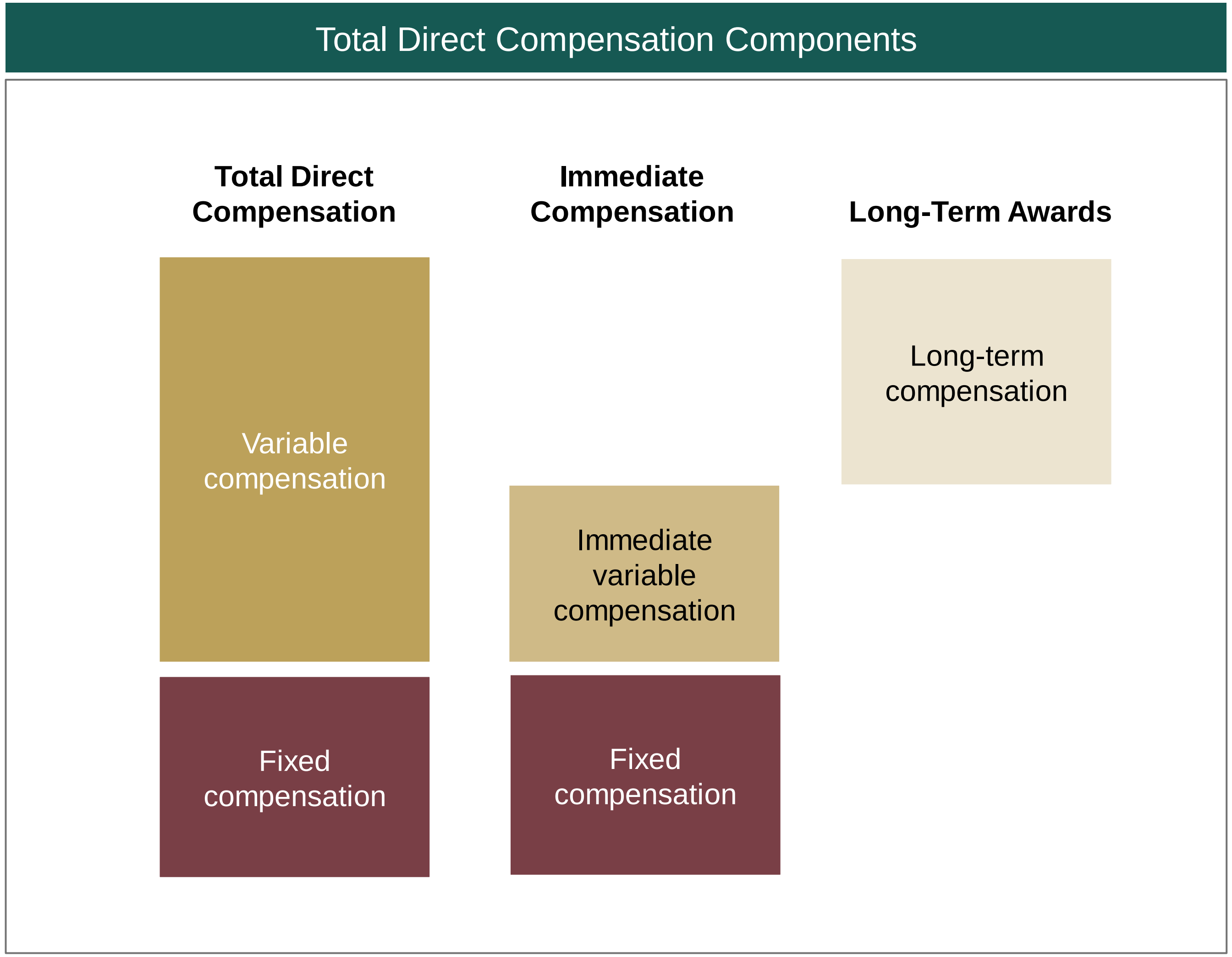


- This HCM study covers 30 banks and financial services companies, selected from the HCM Top 100 data set, based on market capitalization as of December 31st, 2019 and the Industry Classification Benchmark (ICB), respectively.
- A total of 28 companies was analysed. Two companies were excluded from the analysis due to disclosure and comparability reasons[1].
- The segmentation as illustrated in the graph on the left by sub-industries and size allows for an increased comparison relevance[2].

1. Pure holding companies were excluded. 2. A market capitalization threshold of CHF 10bn was applied for large cap banking & investment services firms.

HCM methodology for compensation analysis

- Pay packages are analyzed separately for the Chief Executive Officer (CEO)[1] and other Executive Board (EB) members[2] on average.
- We consider TDC, i.e. excluding social securities, pension contributions, other benefits, any replacement awards, or gains from any share purchase programs.
- TDC is composed of:
  - Fixed compensation,
  - Immediate variable compensation, and
  - long-term compensation.
- Variable compensation covers attributable compensation for the year – accrued or granted, rather than paid out.
- Where possible, long-term compensation awards are estimated at their fair value at grant, reflecting the expected value of a particular instrument considering future payout risks.
- All absolute values are reported in CHF.

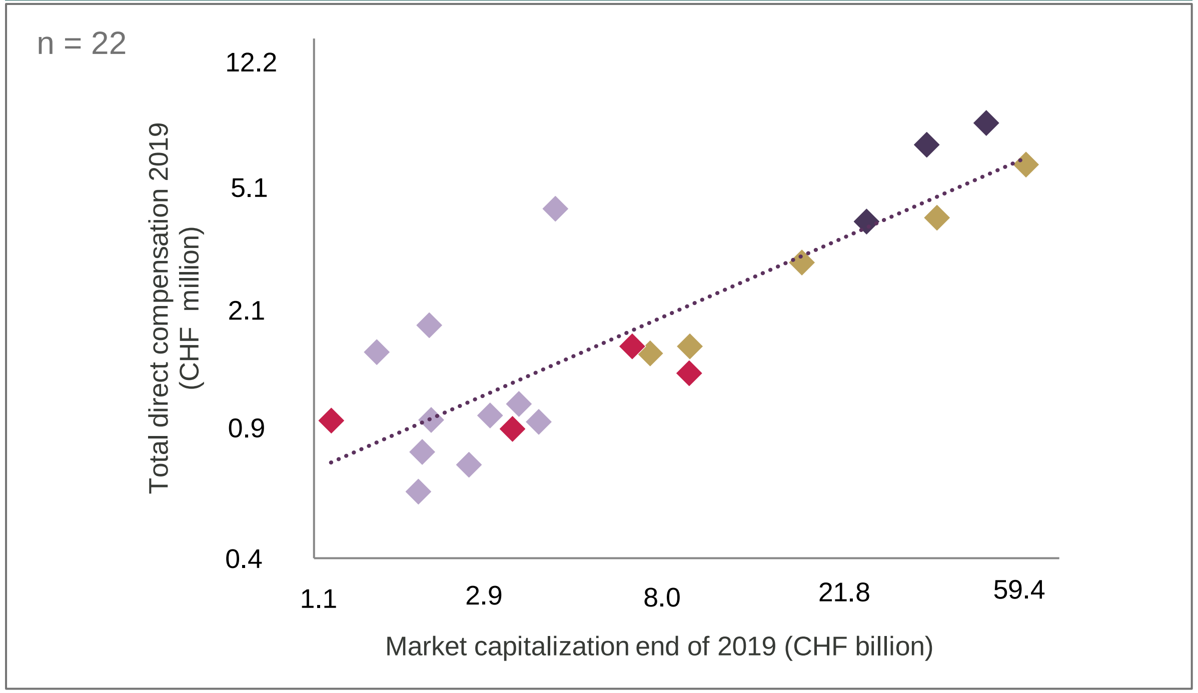


1. For comparison reasons, CEOs who were not in office for the full year are excluded from any trend analyses. 2. Includes any EB member other than CEO, e.g. CFO, COO, operational, and functional executive officers.

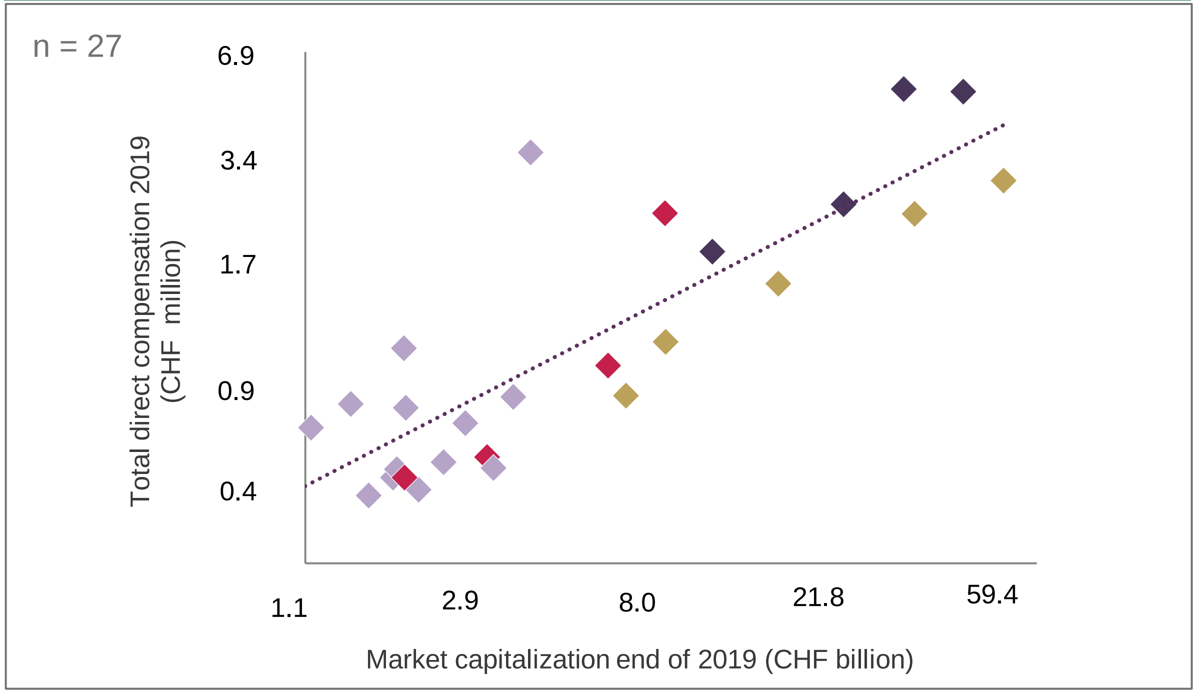
Compensation Level

Material relationship between compensation level and company size

Link between CEO's pay and company size, 2019



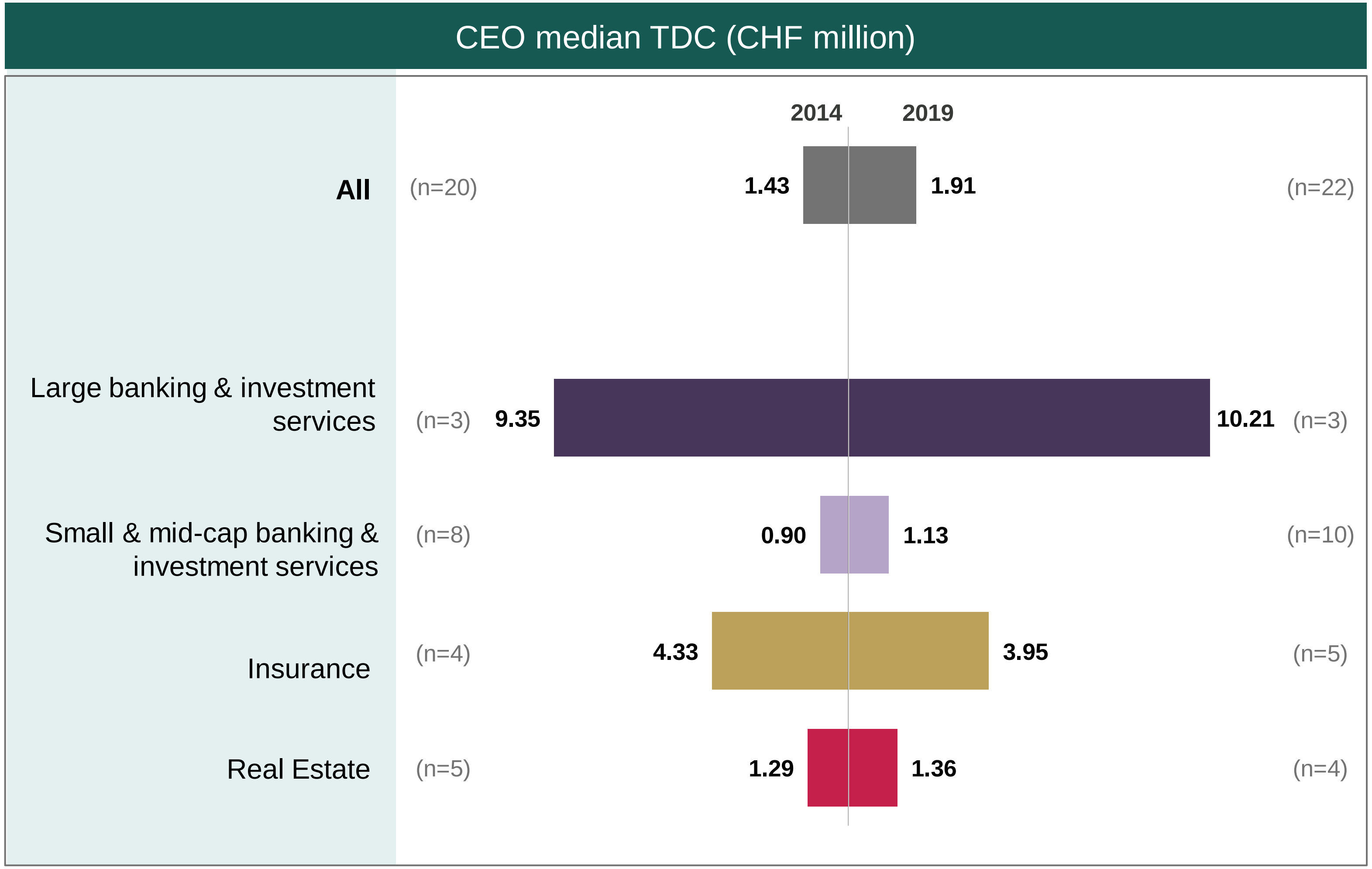
Link between EB members' pay and company size, 2019



Large banking & investment services | Small & mid-cap banking & investment services | Insurance | Real Estate

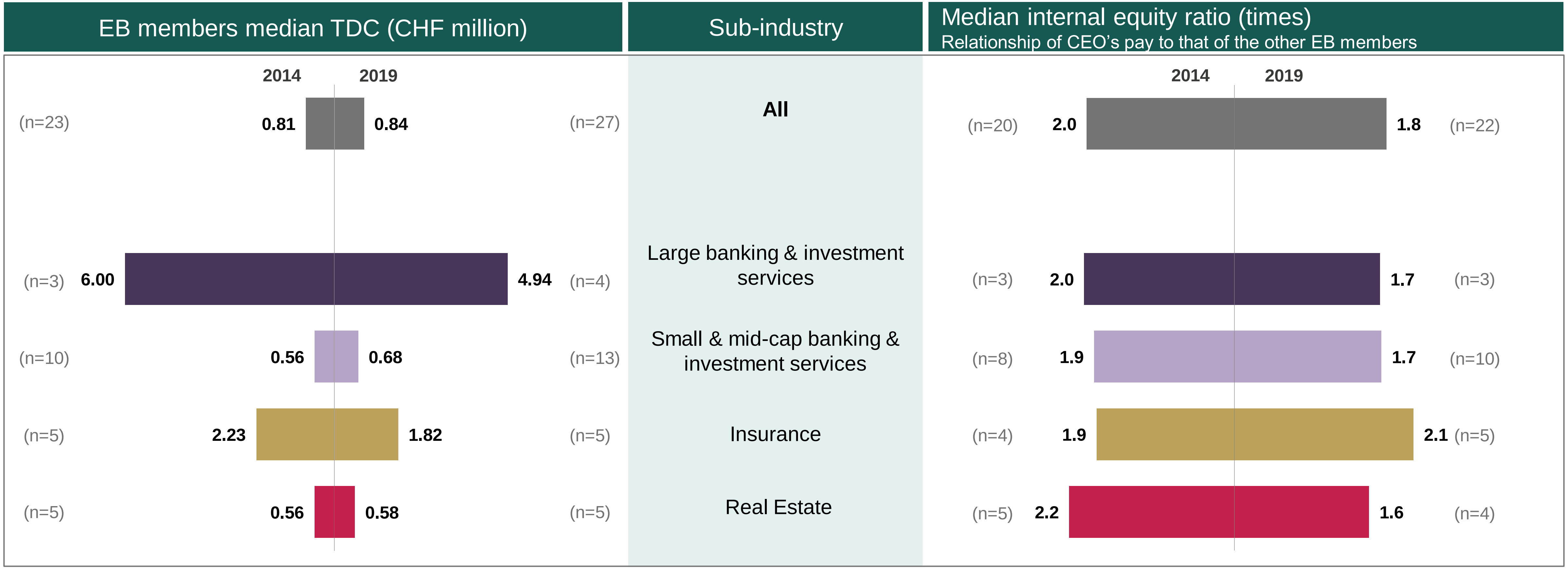
- Based on the above illustrated regression analyses, the variation in CEO and EB members total direct compensation can be well explained by differences in company size (R-squared approx. 70%).

Compensation level of CEO continues to rise



- Based on a 5-year comparison (2014 vs. 2019), the median compensation level for CEOs considerably increased by 33.6%.
- For different sub-industries, CEO pay levels increased within a bandwidth of 5.4% for Real Estate to 25.5% for small and mid-cap banks in 2019 when compared to 2014. Nonetheless, a decrease of 8.8% was noted for the insurance industry.

Compensation level continues to increase for other EB members



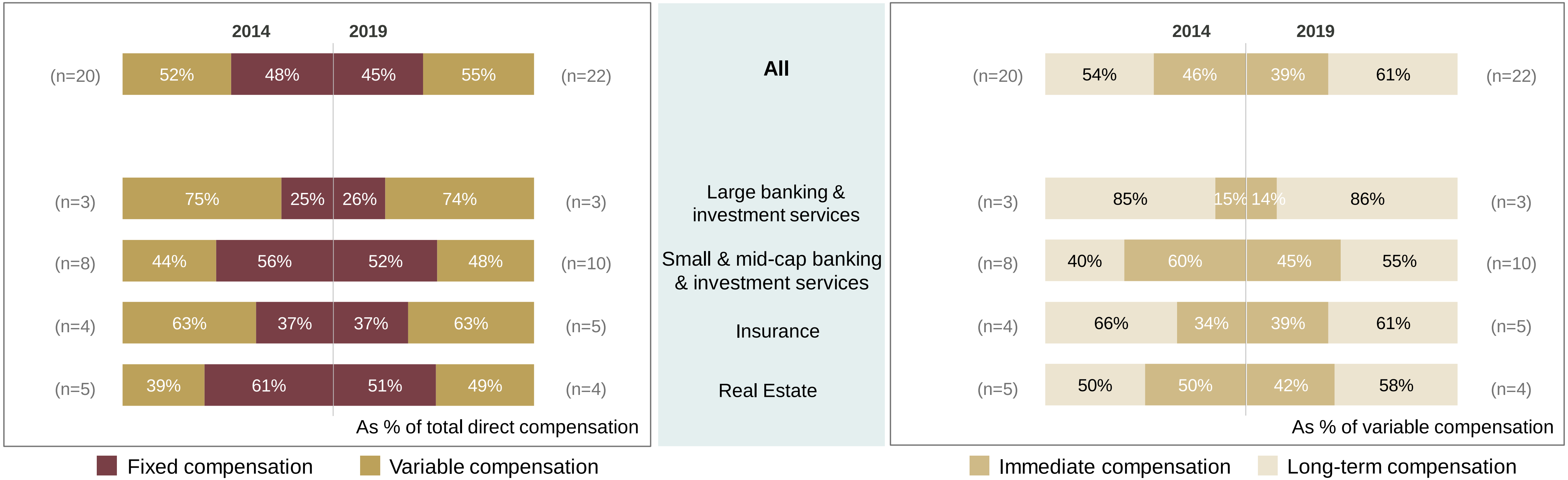
- Overall, an increase of 3.7% compared to 2014 in median pay levels for EB members can be observed. When looking at the subsectors, compensation for EB members changed similarly to that of CEOs, however, there was a considerable decrease at large banks (-17.7%).
- In 2019, CEOs were paid 1.8 times the TDC of EB members. While the multiple was higher in 2014, it has especially decreased at real estate companies and increased at insurance companies. For both banking groups, the multiple development is aligned.

Compensation Structure

HCM International

Over half of executive compensation is variable for CEOs

Average fixed vs variable for CEO	Sub-industry	Average deferral of variable compensation for CEO

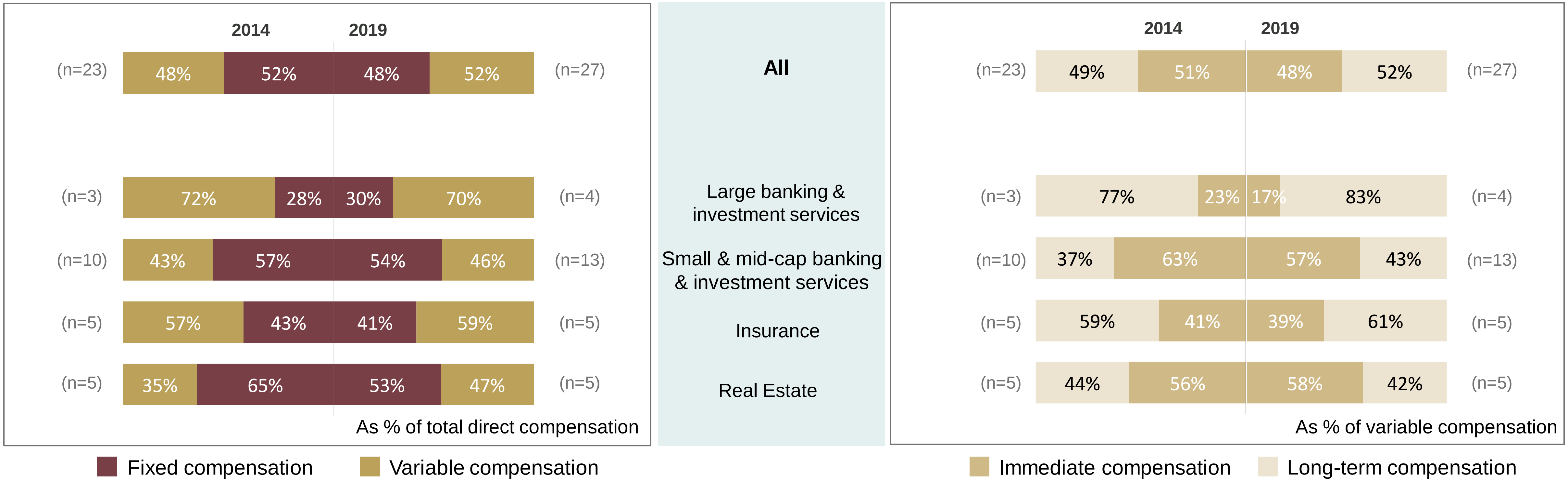


- In general, the weighting of variable compensation and long-term compensation increases with the size of the company and the overall amount of TDC.
- The overall pay mix is quite balanced in terms of fixed pay and variable compensation. Nevertheless, small and mid-cap banking & investment services companies pay a relatively lower portion of variable compensation.
- On average, companies pay a significant part of variable pay in long-term compensation, which has also increased since 2014.

Over half of executive compensation is variable for other EB members

HCM International

Average fixed vs variable for EB members	Sub-industry	Average deferral of variable compensation for EB members

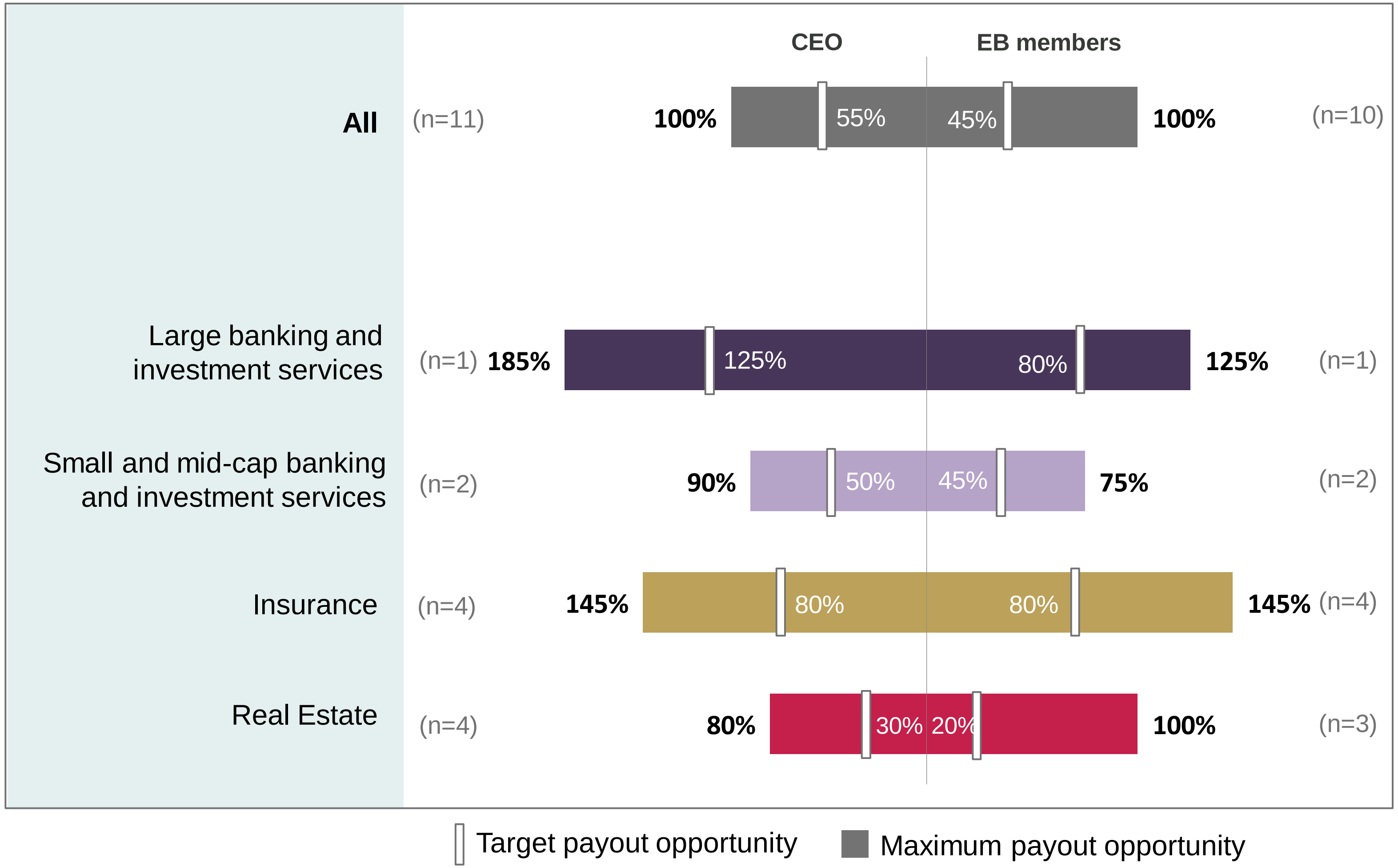


- There is similar evidence as that for the pay mix for CEOs as that for other members of the Executive Board. The overall pay mix is almost equally weighted between fixed pay and variable compensation.
- However, the weighting of long-term compensation is typically lower than for CEOs and has remained relatively stable since 2014.

Variable Pay Design

Immediate variable compensation payout opportunities for CEO and EB members in 2019

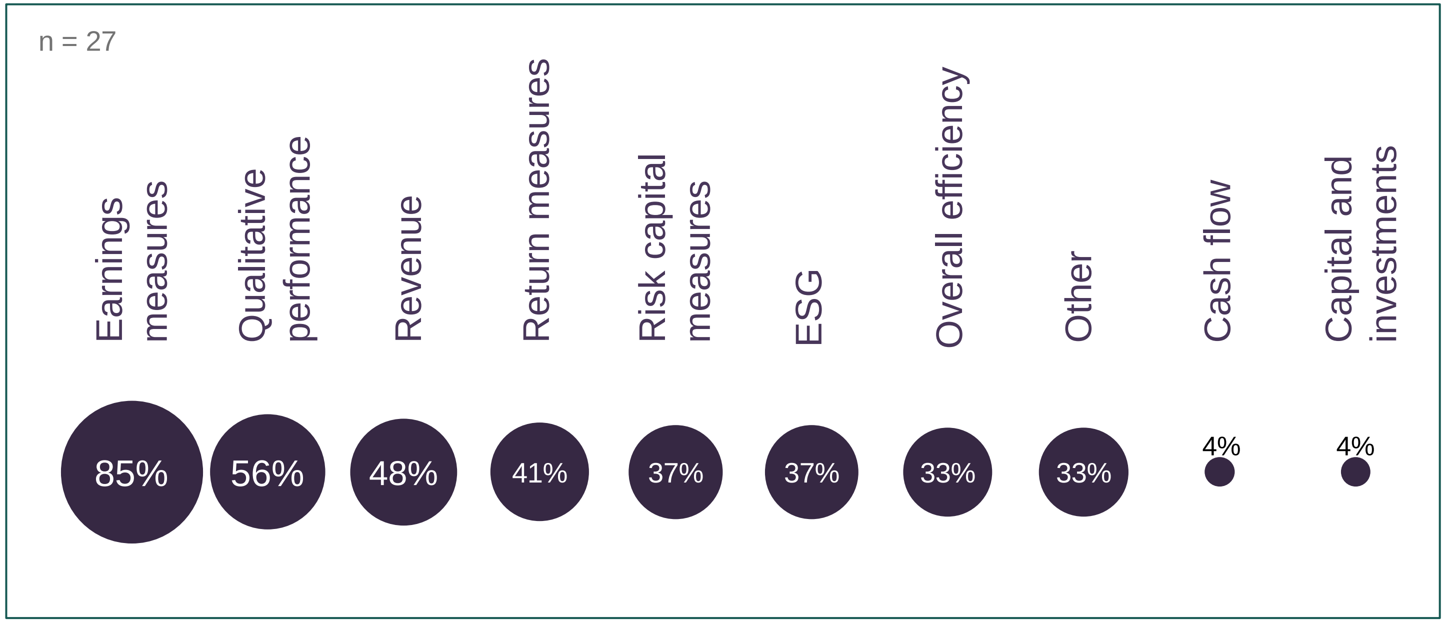
Median immediate variable compensation payout opportunity, % of base salary



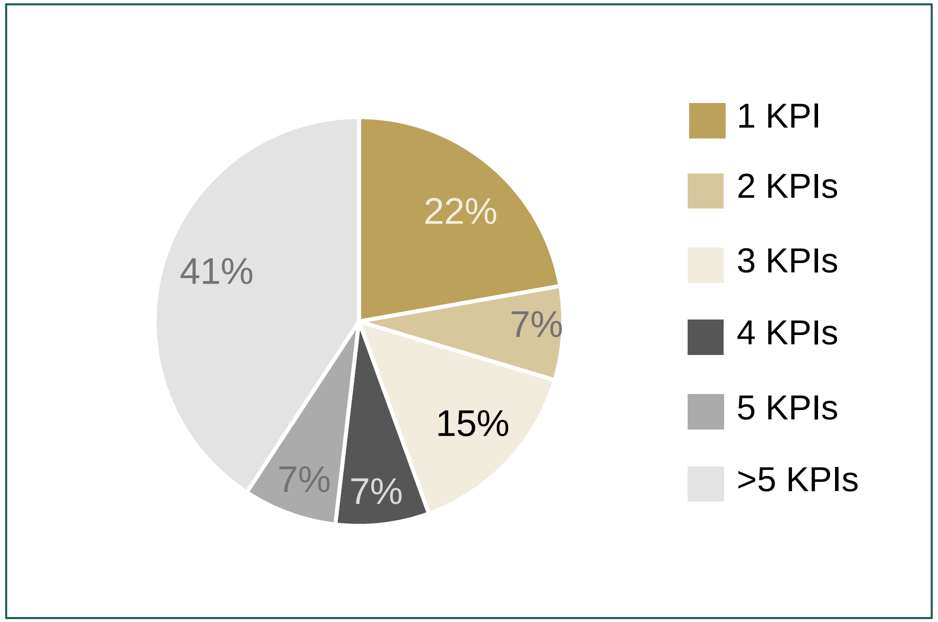
- 39% of companies have target bonus models in place to govern their immediate variable compensation.
- Target levels for financial firms at median were 55% of base salary for CEOs and 45% of base salary for other EB members.
- Size differences had a decisive influence on the immediate variable compensation design. Large banking and investment service companies tend to perceivably construct compensation packages with higher payout opportunities for the CEO and other EB members.
- The maximum immediate variable compensation opportunity (cap) as a percentage of base salary also increased with the company's size.

Earning measures and qualitative performance continue to be the most prevalent metrics for immediate variable compensation

KPI for immediate variable compensation



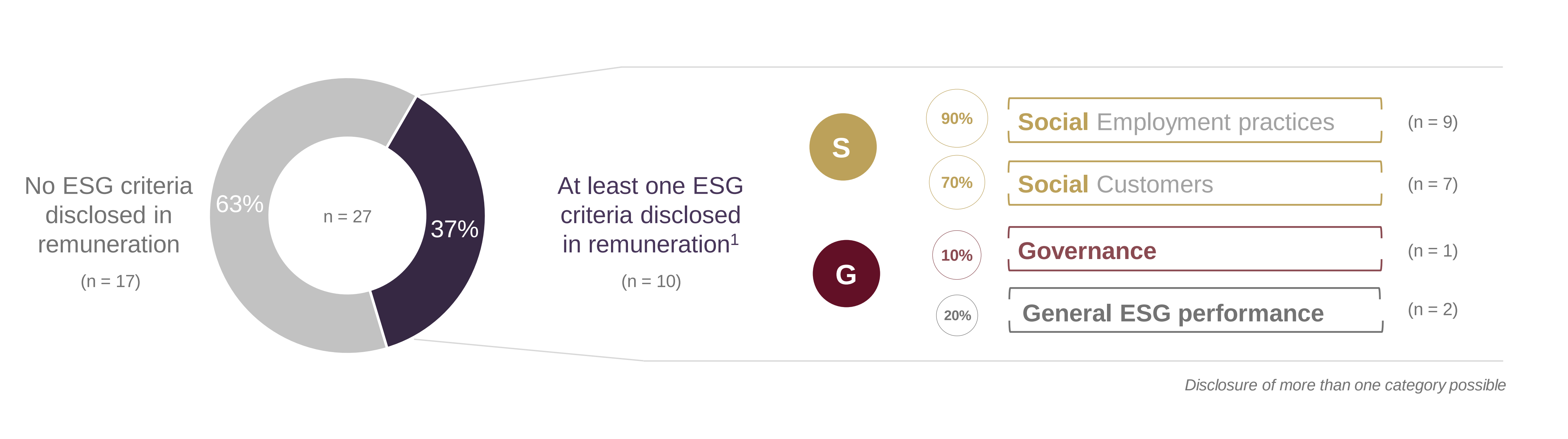
Number of KPIs in immediate variable compensation



- There is a clear tendency (93% of analyzed companies) to combine individual and corporate performance metrics when defining the immediate variable compensation for members of the Executive Board.
- Earnings measures[1] and qualitative performance[2] continue to be the most popular metrics. Sustainability (ESG) related indicators came in sixth[3] in terms of prevalence.
- Companies typically use more than 5 performance indicators for determining the immediate variable compensation (41%). However, a approximately fourth (22%) of companies rely on a single metric only.

1. This includes such metrics as EPS, Annual Profit, Cost-income ratio, Gross margin, Net profit, Operating profit etc. 2. This includes, for example behavioral and risk aspects. 3. See next page for details.

Use of ESG measures is getting more explicit



- 37% of the financial companies disclose a link of ESG initiatives to variable pay. Even though this seems "low" compared to financial targets (for example, 85% of the financial companies use Earnings measures metrics for immediate variable compensation), it is still an important signal that serves as proof of commitment and accountability in this subject.
- The prevalent ESG category relates to "Social – Employment Practices" with companies typically using 1-2 different ESG categories and often disclosing 1-2 targets per category. Categories such as "Environment" and "Social – Society" were not present in financial companies in 2019.

1. Companies typically use more than one ESG category. For financial companies, measures related to regulatory compliance and risk assessment are required by regulators. To focus on the perspective of incentivizing ESG practices (and not regulatory compliance), such criteria are excluded here.

Prevailing performance-based instruments for 2019 long-term compensation

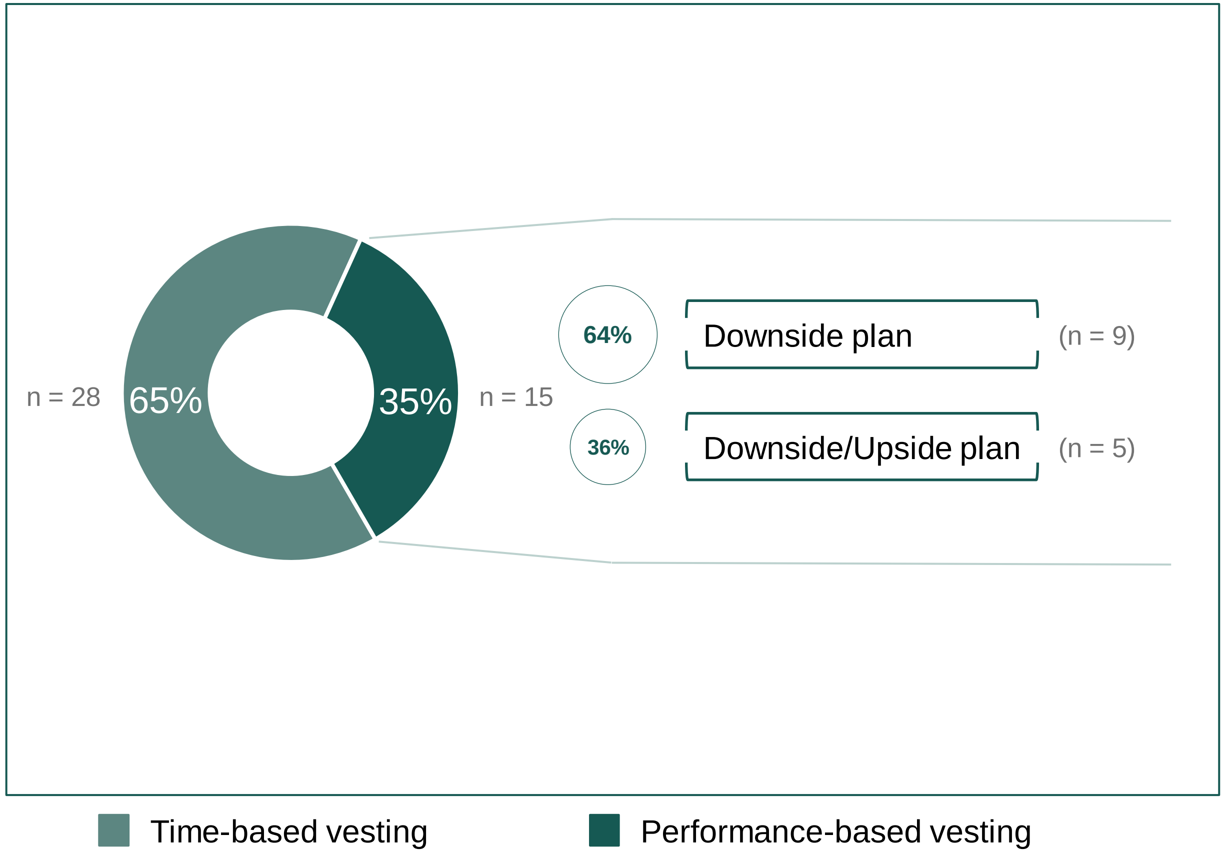
Funding Approach	Instrument	Prevalence (% of plans used)	Prevalence (% of granted amounts)	Average blocking/vesting/ performance period (years)
Performance driven grants	Blocked shares	35%	10%	5
	Restricted shares	7%	2%	3
	Deferred cash	9%	7%	4
	Performance shares	2%	18%	5
	Performance cash	2%	2%	3
	Debt instruments	2%	11%	5
	Stock options	0%	0%	
		58%	**50%**	
Stand-alone grants	Performance shares	26%	43%	4
	Blocked shares	5%	0%	5
	Restricted shares	5%	4%	5
	Stock options	7%	2%	4 +1
	Performance cash	0%	0%	
	Deferred cash	0%	0%	
	Debt instruments	0%	0%	
		42%	**50%**	

Axis (years): 1 2 3 4 5 …

n = 43

Performance instruments: Prevalence of downside / upside plans in 2019

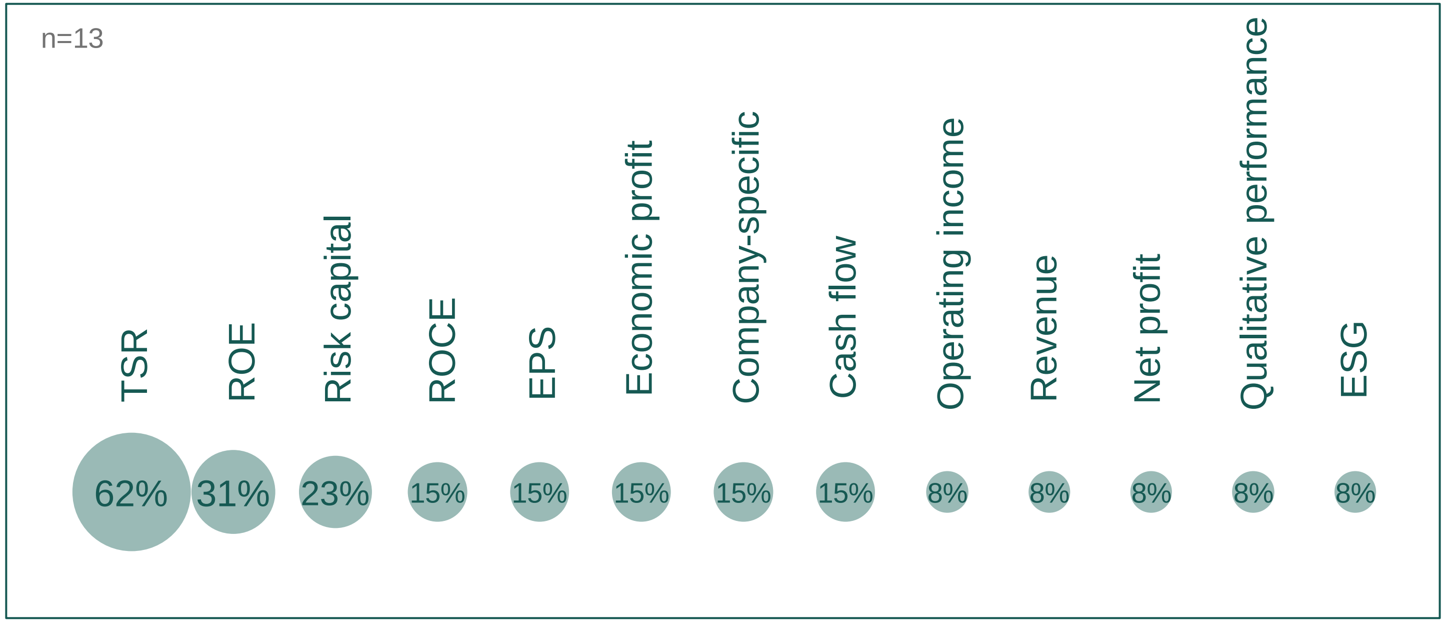
Performance instruments, % of long-term compensation plans



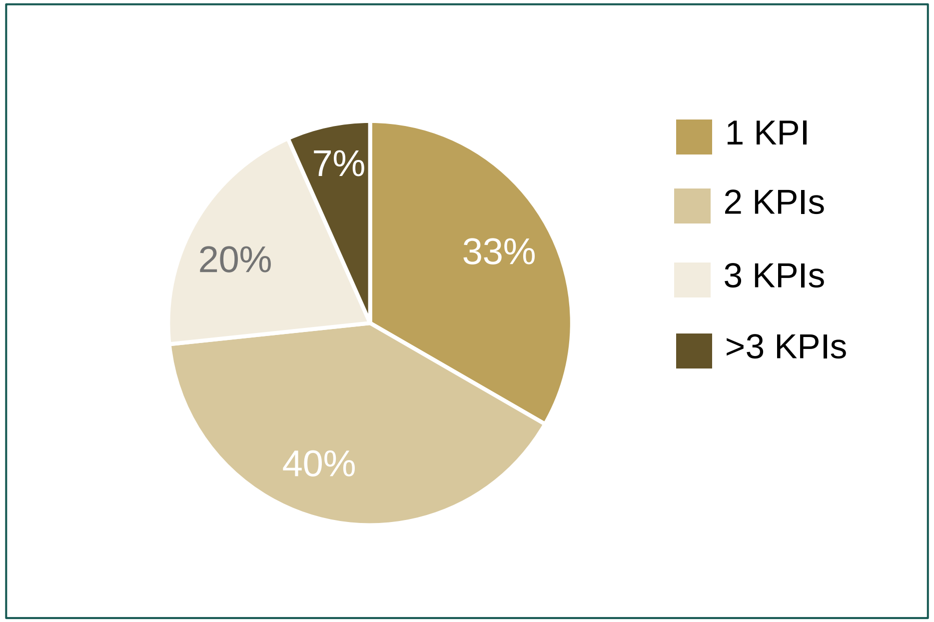
- The payout of performance-based LTI awards can be adjusted depending on the achievement of targets at the end of the performance period:
  - only downwards in case of underperformance (downside plans),
  - either increased or decreased – downside/upside plans.
- Plans with upside typically show a leverage of 200% (at median).

TSR continues to be the most used performance metric for LTI plans with performance-based vesting

KPI for LTIs in 2019



Number of KPIs in LTIs



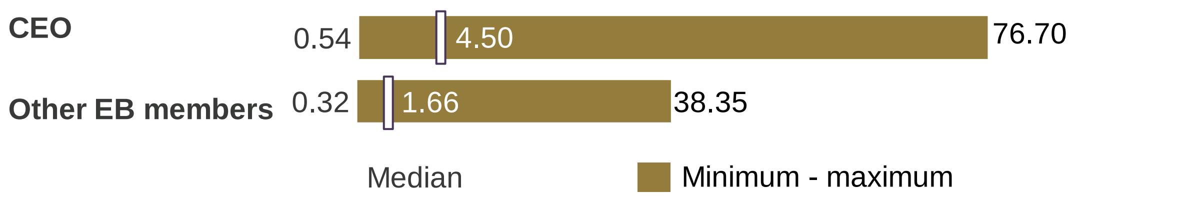
- KPIs in LTI plans are typically driven by pure financial metrics with qualitative measures proving to be less prevalent.
- TSR continues to be the most frequently used performance metric (62% of companies), also majorly being measured on a relative basis (88% of plans).
- Companies typically use 1 (33%) – 2 (40%) performance indicators for the vesting of LTI plans.

Shareholding Requirements

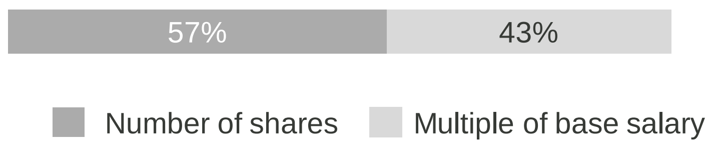
HCM International

Shareholding requirements

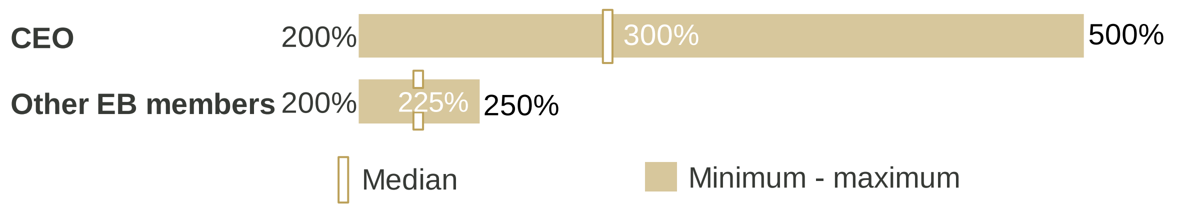
Stock ownership requirement in CHF million



Stock ownership requirement type



Multiple of base salary: stock ownership requirement, % base salary



- In 2019, 7 out of the 28 analyzed companies had equity ownership policies in place for their EB members.
- Such requirement is expressed in the form of:
  - a multiple of base salary (43% of companies) and
  - as number of shares (57% of companies).
- Executives were expected to reach the required level of shareholdings within a range of 3 to 5 years (5 years at median).
  - Furthermore, the types of shares that count toward the guidelines typically included directly owned shares and vested equity awards.
- Common restrictions for non-compliance with the requirements included e.g. the prohibition to sell any vested share awards.

1. Statistic applicable for all companies disclosed shareholding requirement: calculated as year end share price multiplied by number of shares (in case requirement expressed in the form of share number) or base salary multiplied by percentage of base salary (in case expressed in percentage of base salary).

About HCM International

HCM at a glance

HCM International

- HCM is a leading independent international advisory firm specialized in the strategic and more challenging aspects of **corporate governance & compliance, finance & risk, and compensation**.
- Since foundation in 2001, we have advised more than 350 companies, of which around two-thirds are privately owned firms. Looking at the listed market in Switzerland, 11 out of the 20 SMI companies and 13 out of the 28 SMIM companies account for our clientele. We also serve public organizations.
- Around the world, our company clients have included large multinationals and mid-sized companies in locations as different as the Gulf, the U.S., and the UK.
- HCM chairs the Global Governance and Executive Compensation Group (GECN); for details visit http://gecn.com.

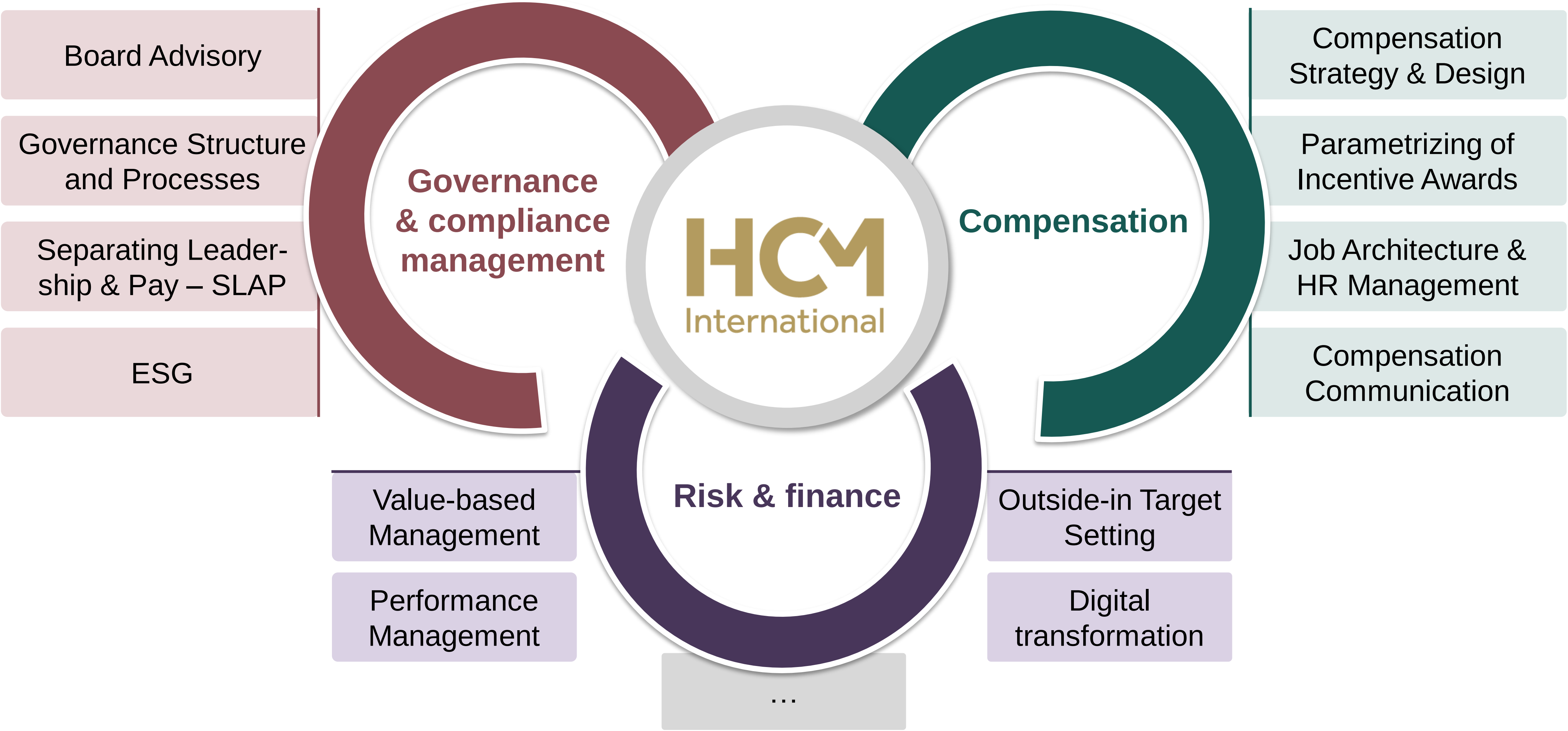
2001 Foundation

350+ Clients

25 Professionals in Switzerland

GECN GROUP – GLOBAL GOVERNANCE AND EXECUTIVE COMPENSATION GROUP — Chair of GECN

We assist companies in managing and bringing agility to the complex interrelationship among…



Your contacts for this project

Dr. Axel May
Senior Partner

+41 44 560 33 09
+41 79 327 56 99
axel.may@hcm.com

Dr. Hanna Hummel
Senior Manager

+41 44 560 33 13
+41 79 525 79 25
hanna.hummel@hcm.com

HCM International | HOSTETTLER & COMPANY
Governance. Risk & Finance. Compensation.

HCM International Ltd.

Mühlebachstrasse 23/25 | CH-8008 Zürich
Phone: +41 44 560 33 33

4 Rue du Commerce | CH-1204 Geneva
Phone: +41 22 339 88 50

international@hcm.com
hcm.com